93-714

No. 93-___

IN THE

Supreme Court of the United States

October Term, 1993

U.S. BANCORP MORTGAGE COMPANY,
Petitioner,
v.
BONNER MALL PARTNERSHIP,
Respondent.

PETITION FOR WRIT OF CERTIORARI
TO THE UNITED STATES COURT OF APPEALS
FOR THE NINTH CIRCUIT

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November 2, 1993

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QUESTION PRESENTED

Whether the new value exception to the absolute priority rule survived enactment of the Bankruptcy Reform Act of 1978, permitting the debtor in a Chapter 11 bankruptcy case to confirm a nonconsensual plan of reorganization which allows the debtor's equityholders to retain ownership of the reorganized debtor while paying objecting creditors less than the full amount of their claims.

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U.S. Bancorp Mortgage Company ("U.S. Bancorp")[1] petitions this Court for a writ of certiorari to the United States Court of Appeals for the Ninth Circuit to review the judgment in *Bonner Mall Partnership v. U.S. Bancorp Mortgage Co. (In re Bonner Mall Partnership)*, 2 F.3d 899 (9th Cir. 1993). Respondent is Bonner Mall Partnership ("Bonner"), a debtor in possession under Chapter 11 of the Bankruptcy Code.

OPINIONS BELOW

On December 6, 1991, the United States Bankruptcy Court for the District of Idaho decided to grant U.S. Bancorp relief from the automatic stay to foreclose Bonner's sole significant asset. The Bankruptcy Court's Memorandum of Decision is unofficially

[1] The parent corporation of U.S. Bancorp Mortgage Company is U.S. Bancorp. U.S. Bancorp Mortgage Company is affiliated with U.S. Bank of Oregon, U.S. Bank of Washington, and U.S. Bank of California.

reported at 1991 Bankr. LEXIS 1402, 1991 WL 330784 and reprinted at Appendix A118-29. The Bankruptcy Court entered a separate Order Denying Motion to Dismiss and Granting Motion for Relief from Stay on December 11, 1991. The United States District Court for the District of Idaho reversed the Bankruptcy Court's decision on July 15, 1992, and entered a further Correction Order on July 23, 1992. The District Court's Opinion and Order, as corrected, is reported at 142 B.R. 911 and reprinted at Appendix A88-117. Such Order was affirmed by the Court of Appeals for the Ninth Circuit pursuant to an Opinion and separate Order filed and entered on August 4, 1993. The Court of Appeals' Opinion is reported at 2 F.3d 899 and reprinted at Appendix A1-84.

JURISDICTION

This petition arises under the Bankruptcy Reform Act of 1978 (the "Bankruptcy Code"), 11 U.S.C. § 101 *et seq*. The date of the decision of the Court of Appeals for the Ninth Circuit is August 4, 1993. This Court has jurisdiction pursuant to 28 U.S.C. § 1254(1).

STATUTORY PROVISION INVOLVED

Section 1129 of the Bankruptcy Code, 11 U.S.C. § 1129, provides in relevant part:

(a) The court shall confirm a plan only if all of the following requirements are met:

. . .

(8) With respect to each class of claims or interests--

(A) such class has accepted the plan; or

(B) such class is not impaired under the plan.

. . .

(b) (1) Notwithstanding section 510(a) of this title, if all of the applicable requirements of subsection (a) of this section other than paragraph (8) are met with respect to a plan, the court, on request of the proponent of the plan, shall confirm the plan notwithstanding the requirements of such paragraph if the plan does not discriminate unfairly, and is fair and equitable, with respect to each class of claims or interests that is impaired under, and has not accepted, the plan.

(2) For the purpose of this subsection, the condition that a plan be fair and equitable with respect to a class includes the following requirements:

. . .

(B) With respect to a class of unsecured claims--

(i) the plan provides that each holder of a claim of such class receive or retain on account of such claim property of a value, as of the effective date of the plan, equal to the allowed amount of such claim; or

(ii) the holder of any claim or interest that is junior to the claims of such class will not receive or retain under the plan on account of such junior claim or interest any property.

STATEMENT OF THE CASE

I. Basis for Federal Jurisdiction

The jurisdiction of the Bankruptcy Court was invoked under 28 U.S.C. §§ 1334 and 157(b). The jurisdiction of the District Court was invoked under 28 U.S.C. § 158(a). The jurisdiction of the Court of Appeals was invoked under 28 U.S.C. § 158(d).

II. Statement of Facts

This case concerns the ability of Bonner's equityholders to retain their ownership of the Bonner Mall (the "Mall"), a shopping

center located in Bonner County, Idaho. The Mall was built by Northtown Investments using a $6.3 million loan from First National Bank of North Idaho. Northtown Investments signed a note and a deed of trust on the Mall. U.S. Bancorp acquired the note and deed of trust in 1986.

Bonner is an Idaho general partnership that was formed for the purpose of acquiring and operating the Mall. On October 31, 1986, Bonner purchased the Mall from Northtown Investments, subject to U.S. Bancorp's lien on the Mall. The Mall is Bonner's only significant asset.

The Mall turned out to be a bad investment, and Bonner has been unable to pay its expenses out of the Mall's income. Bonner serviced the debt to U.S. Bancorp until July 1, 1990 by deferring maintenance and repairs to the Mall and by not paying its real estate taxes to Bonner County.

On July 10, 1990, U.S. Bancorp commenced a nonjudicial foreclosure of the Mall because of Bonner's failure to pay real estate taxes on the Mall, commencing with 1987 taxes. U.S. Bancorp agreed to three requests by Bonner to postpone the foreclosure sale of the Mall, finally resetting the sale for March 14, 1991. On March 13, 1991, Bonner filed a petition under Chapter 11 of the Bankruptcy Code. Bonner is a debtor-in-possession pursuant to 11 U.S.C. §§ 1101 and 1107.

On April 23, 1991, U.S. Bancorp moved for relief from the automatic stay, *see* 11 U.S.C. § 362, to foreclose its interest in the Mall on the grounds, among others, that Bonner could not confirm a plan of reorganization. The Bankruptcy Court denied relief, subject to the proviso that Bonner propose a plan of reorganization that was not unconfirmable as a matter of law. The Bankruptcy Court also valued the Mall at $3.2 million.

On October 31, 1991, Bonner filed its First Amended Plan of Reorganization (the "Plan") and related First Amended Disclosure Statement. Under the Plan, Bonner would transfer all of its assets to

a new entity, Bonner Properties, Inc. ("Bonner Properties") in return for Bonner Properties' assumption of Bonner's liabilities as set forth in the Plan.

The Plan provided that the $3.2 million portion of U.S. Bancorp's claim which is fully secured by the Mall would be paid 32 months after the Plan's confirmation, with 7% annual interest payable monthly in the interim. Other secured creditors also would be paid the value of their collateral on a deferred basis. No cash whatsoever would be distributed with respect to more than $3.6 million in unsecured claims against Bonner, including the undersecured portion of U.S. Bancorp's claim, which constituted approximately 93% of all unsecured claims. Instead, all unsecured claims of more than $1,000 would be satisfied through a pro-rata distribution of 300,000 shares of Bonner Properties redeemable preferred stock having a par value and liquidation preference of $300,000. Thirty-two months after the Plan's confirmation, the preferred stock would be convertible into 15% of the then-outstanding common stock of Bonner Properties.

Under the Plan, Bonner's existing partners would contribute to Bonner Properties $200,000 cash and a 32-month undertaking to fund any shortfall in Bonner Properties' working capital in return for 2,000,000 shares (100%) of Bonner Properties common stock. The Plan would give Bonner's partners the exclusive right to acquire the common stock, except for the shares which could be issued to unsecured creditors upon the conversion of the preferred stock.

The Plan does not meet the requirements of Section 1129(b)(2)(B)(i) of the Bankruptcy Code, *see supra* page 3, because the holders of more than $3.6 million of unsecured claims are to receive only $300,000 in liquidation value of preferred stock. Accordingly, the Plan can only be confirmed under Section 1129(b) of the Bankruptcy Code (a "cramdown" confirmation) if Section 1129(b)(2)(B)(ii) is satisfied. The requirement of Section 1129(b)(2)(B)(ii) embodies what is known as the "absolute priority rule." The Plan violates the absolute priority rule because Bonner's owners will retain property under the Plan, despite the failure to pay

unsecured claims in full. The Plan therefore can be confirmed only if there is an exception or corollary to the absolute priority rule which permits a debtor's owners to contribute new value to the reorganized debtor in return for the property they receive or retain under the plan of reorganization. Bonner relies on such a "new value" exception or corollary to the absolute priority rule to confirm the Plan.[2]

III. Procedural History

In response to Bonner's Plan, U.S. Bancorp renewed its motion for relief from the automatic stay to foreclose its interest in the Mall. U.S. Bancorp argued that the Plan was unconfirmable as a matter of law because it relied on the new value exception to the absolute priority rule. The Bankruptcy Court agreed, holding that the new value exception did not survive enactment of the Bankruptcy Code, and issued on December 6, 1991 the Memorandum of Decision reprinted at Appendix A118-29. The Bankruptcy Court stayed its decision pending appeal.

On July 15, 1992, the District Court reversed the Bankruptcy Court's Order and held that the new value exception survived enactment of the Bankruptcy Code. *See* Appendix A88-117. The District Court remanded the case to the Bankruptcy Court for further proceedings.

U.S. Bancorp appealed the District Court's decision to the Court of Appeals for the Ninth Circuit. The Court of Appeals requested supplemental briefing by the parties on the question whether, in light of the remand of the case to the Bankruptcy Court, the District Court's decision was a final order for purposes of 28 U.S.C. § 158(d).

On August 4, 1993, the Court of Appeals issued its Opinion. *See* Appendix A1-84. It agreed with the parties that the District Court's decision was a final order for purposes of 28 U.S.C. § 158(d),

[2] The Plan has been amended in various regards since the Court of Appeals' decision, but still relies on the new value exception.

reasoning that the central issue in the appeal was legal in nature and its resolution could clearly dispose of the case and obviate the need for factfinding. *See* Appendix A12-19. The Court of Appeals then affirmed the decision of the District Court and remanded the case to the Bankruptcy Court for further proceedings.

ARGUMENT FOR ALLOWANCE OF THE WRIT

In *Case v. Los Angeles Lumber Products Co.*, 308 U.S. 106 (1939), this Court recognized in dicta a new value exception to the absolute priority rule under the Bankruptcy Act of 1898 (the "Bankruptcy Act"). In 1978 the Bankruptcy Code replaced the Bankruptcy Act. In *Norwest Bank Worthington v. Ahlers*, 485 U.S. 197 (1988), this Court questioned, but did not decide, whether the new value exception survived enactment of the Bankruptcy Code. *Id.* at 203 n.3. This case raises the same question.

In its decision below, the Court of Appeals for the Ninth Circuit noted that–

> Whether [the new value exception] is viable under the Bankruptcy Code has significant implications for the relative bargaining power of debtors and creditors in Chapter 11 cases. Although no circuit court has taken a definitive position on this question, *dicta* in several opinions demonstrate intra- and inter-circuit disagreements. District and bankruptcy courts are sharply divided on the question, as are the commentators. The question will in all probability ultimately be decided by the Supreme Court.

Appendix A2-3.

I. Survival of the New Value Exception is an Important, Unsettled Question of Federal Law

The survival of the new value exception is an important question of federal law which has not been, but should be, settled by this Court.

The Court of Appeals is correct in its statement that survival of the new value exception has significant implications for the relative positions of debtors and creditors in Chapter 11 cases. The new value exception would profoundly diminish creditors' control over the reorganization process. As the Court of Appeals for the Seventh Circuit explained in *Kham & Nate's Shoes No. 2, Inc. v. First Bank of Whiting*, 908 F.2d 1351, *reh'g and reh'g en banc denied* (7th Cir. 1990), "A 'new value exception' means a power in the *judge* to 'sell' stock to the managers even when the creditors believe that this transaction will *not* augment the value of the firm." *Id.* at 1360 (emphasis in original). The Court of Appeals for the Fifth Circuit has expanded on this point:

> [P]ermitting the courts, pursuant to a "new value exception," rather than the creditors, under a strict absolute priority rule, to determine the conditions of former equity owners' participation in a reorganized debtor introduces an enormously complicating factor in a carefully balanced bargaining structure. . . . Creditors and the debtor [would be] left to guess, *not what each other's* "bottom line" *position is* for a consensual plan, *but rather what the particular court sees* as a "bottom line" cash contribution that will permit cramdown of an old equity plan under the "new value exception." . . . Negotiations between creditors and the debtor against such a "new value exception" backdrop would be enormously skewed in favor of old equity and would seriously erode the utility of the creditors' votes.

Phoenix Mut. Life Ins. Co. v. Greystone III Joint Venture (In re Greystone III Joint Venture), 948 F.2d 134, 144 (1991) (emphasis in original), *petition for reh'g granted in part, opinion withdrawn in relevant part*, 995 F.2d 1274, 1284 (5th Cir.) (per curiam) (Jones, J.,

dissenting from withdrawal), *cert. denied*, ___ U.S. ___, 113 S. Ct. 72, 121 L. Ed. 2d 37 (1992).

This issue occurs frequently in bankruptcy cases and is of considerable importance to the lending community. The issue raises significant public policy considerations in that the existence of the new value exception adds tremendous uncertainty to credit markets. The new value exception in essence allows a bankruptcy court to write new loans for lenders on terms they never envisioned and which, in their business judgment, they would not consider prudent. In that regard, U.S. Bancorp understands that other lenders and associations of lenders are likely to request permission to file amicus briefs in support of this petition and, if certiorari is granted, on the merits.

The determination whether the new value exception survives also implicates the broader issue of application of doctrines created by the courts under the Bankruptcy Act to cases administered under the Bankrupty Code. *See infra* pages 12-13. These issues relate solely to federal law.

The survival of the new value exception has not been settled by this Court. In the *Ahlers* case the Solicitor General of the United States, as amicus curiae, urged this Court to hold that codification of the absolute priority rule in the Bankruptcy Code eliminated any new value exception. 485 U.S. at 203 n.3. This Court refused the Solicitor General's suggestion because it did not need to reach the survival of the new value exception to resolve the issues before it in *Ahlers*. "Thus, our decision today should not be taken as any comment on the continuing vitality of the Los Angeles Lumber exception--a question which has divided the lower courts since passage of the Code in 1978." *Id.* This issue, and the question of statutory interpretation of the Code, remains very much in dispute. *See infra* pages 13-16.

II. The Decision Below Conflicts with Applicable Decisions of this Court

The Court of Appeals' decision conflicts both with this Court's decision in the *Ahlers* case and a line of this Court's decisions interpreting the Bankruptcy Code originating with *Midlantic Nat'l Bank v. New Jersey Dept. of Envtl. Protection,* 474 U.S. 494 (1986).

A. Conflict with *Ahlers*

At the heart of the Court of Appeals' decision in this case is the view that the new value principle is a "corollary," not an exception, to the absolute priority rule:

> We have no difficulty in reconciling the "on account of" language with the new value exception. . . . Several courts have concluded that if a proposed plan satisfies [the requirements of] the new value exception, it will not violate section 1129(b)(2)(B)(ii) of the Code and the absolute priority rule. Such a plan, they reason, will *not* give old equity property *"on account of"* prior interests, but instead will allow the former owners to participate in the reorganized debtor *on account of* a substantial, necessary, and fair new value contribution. We agree with their analysis.
>
> We recognize that in some larger sense the reason that former owners receive new equity interests in reorganized ventures is that they are former owners. But it is also true that in new value transactions old equity owners receive stock in exchange for the additional capital they invest. Causation for any event has many and varied levels. Here, the answer to the meaning of the phrase "on account of" lies in the level of causation Congress had in mind when it prohibited old equity owners from receiving property "on account of" their prior interests. A reading of the full text of section 1129(b)(2)(B)(ii) makes it clear that what Congress had in mind was direct or immediate causation rather than a more remote variety, and that it did not intend to prohibit persons who receive stock because they have provided new capital from becoming participants in the reorganized debtor simply because they were also owners of the original enterprise.

Appendix A37-40 (citations and footnote omitted) (emphasis in original).[3]

The Court of Appeals' conclusion that "A qualifying plan simply does not violate the absolute priority rule," Appendix A42 n.25, is directly at odds with this Court's decision in *Ahlers,* where this Court wrote that "There is little doubt that a reorganization plan in which [debtors] retain an equity interest in the farm is contrary to the absolute priority rule." 485 U.S. at 202 (footnote omitted).[4] Footnote 3 to that decision repeatedly refers to the *Los Angeles Lumber* "exception" to the absolute priority rule. *Id.* at 203 n.3.

By characterizing the new value exception as an extra-statutory corollary to the Bankruptcy Code, rather than an exception to the Code's absolute priority rule, the Court of Appeals shifted the burden to U.S. Bancorp to prove that Congress repealed the new value exception. If, as indicated by this Court in *Ahlers,* the new value principle is in fact an exception to the Bankruptcy Code, the burden of proving its survival after enactment of the Bankruptcy Code should have fallen on Bonner. The Court of Appeals' disregard of this Court's characterization of the new value principle therefore infected its subsequent application of this Court's decisions establishing the proper approach to Bankruptcy Code interpretation.

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[3] The Court of Appeals reasoned that U.S. Bancorp's contrary interpretation of "on account of" would render the phrase superfluous. "Had Congress intended that old equity never receive any property under a reorganization plan where senior claim classes are not paid in full, it could simply have omitted the 'on account of' language from section 1129(b)(2)(B)(ii)." Appendix A40. This is not correct. Holders of junior claims and interests can also hold senior claims. The "on account of" language thus, at a minimum, serves the purpose of allowing such holders to receive property under a plan with respect to their senior claims, though they are barred from receiving property on account of their junior claims or interests if other senior claims are not paid in full.

[4] The debtors did not contest this conclusion in *Ahlers.* *Id.* at 202 n.2.

B. Conflict with the *Midlantic* Line of Cases

The Court of Appeals' decision also conflicts with this Court's carefully elaborated approach, commencing with *Midlantic* and continuing through *Dewsnup v. Timm*, 502 U.S. ___, 112 S. Ct. 773, 116 L. Ed. 2d 903 (1992), to resolution of conflicts between pre-Code judicially-created rules and the Bankruptcy Code.

The Court of Appeals relied on the decisions in *Midlantic, Kelly v. Robinson*, 479 U.S. 36 (1986), *Pennsylvania Dept. of Public Welfare v. Davenport*, 495 U.S. 552 (1990), and *Dewsnup, see* Appendix A51-61, without due regard for the context of those decisions or the dictates of this Court in *United States v. Ron Pair Enters., Inc.*, 489 U.S. 235 (1989), and *Dewsnup*. On the basis of its reading of such cases, the Court of Appeals concluded that "Where the text of the Code does not unambiguously abrogate pre-Code practice, courts should presume that Congress intended it to continue unless the legislative history dictates a contrary result." Appendix A57 (citing *Dewsnup*, 112 S. Ct. at 779).

That conclusion is at odds with the principles set forth in *Ron Pair*:

> *Kelly* and *Midlantic* make clear that, in an appropriate case, a court must determine whether Congress has expressed an intent to change the interpretation of a judicially created concept in enacting the Code. But *Midlantic* and *Kelly* suggest that there are limits to what may constitute an appropriate case. Both decisions concerned statutory language which, at least to some degree, was open to interpretation. Each involved a situation where bankruptcy law, under the proposed interpretation, was in clear conflict with state or federal laws of great importance.

489 U.S. at 245. *See also id.* at 243-45 (explaining particular circumstances of *Midlantic* and *Kelly* cases).

In the *Davenport* case, this Court enforced the plain meaning of the Bankruptcy Code despite the Code's abrogation of pre-Code

practice, *see* 495 U.S. at 560-64, and despite the Code's effect on States' administration of their criminal justice systems. No such countervailing nonbankruptcy policies are implicated by the new value exception. And *Ron Pair*'s threshold requirement that the applicable provision of the Bankruptcy Code be textually ambiguous or rendered uncertain by a clear conflict with other laws of great importance was faithfully followed in *Dewsnup*:

> [W]here the language is unambiguous, silence in the legislative history cannot be controlling. But, given the ambiguity here, to attribute to Congress the intention to grant a debtor the broad new remedy against allowed claims to the extent they become "unsecured" for purposes of § 506(a) without the new remedy's being mentioned somewhere in the Code itself or in the annals of Congress is not plausible, in our view, and is contrary to basic bankruptcy principles.

112 S. Ct. at 779, 116 L. Ed. 2d at 913.

The Court of Appeals ignored the requirement that Section 1129(b)(2)(B)(ii) be open to interpretation or in clear conflict with other laws of great importance before importing pre-Code practice into the Bankruptcy Code. Instead, contrary to *Ron Pair*, it placed the burden on U.S. Bancorp to prove "a clear intent on the part of Congress to eliminate the new value exception." *See* Appendix A61.[5]

III. The New Value Exception has Generated Conflicting Decisions between and within the Courts of Appeal

While the decisions of other Courts of Appeal have stopped short of deciding the survival of the new value exception, they have

[5] The Court of Appeals therefore disregarded U.S. Bancorp's argument that this Court's decisions in *Patterson v. Shumate*, 504 U.S. ___, 112 S. Ct. 2242, 119 L. Ed. 2d 519 (1992), *Toibb v. Radloff*, 501 U.S. ___, 111 S. Ct. 2197, 115 L. Ed. 2d 145 (1991), *Ron Pair*, and *Griffin v. Oceanic Contractors, Inc.*, 458 U.S. 564 (1982), set a high standard for finding ambiguities in a Bankruptcy Code section that is susceptible to a literal application which is not in conflict with other laws.

gone far enough to evidence a serious conflict in views over this issue, have spawned directly conflicting decisions in the lower courts, and have fostered an unusual degree of uncertainty and confusion in this important area of federal law.

Among the Courts of Appeal, the Sixth and Seventh Circuits upheld plans based on the new value exception prior to this Court's decision in the *Ahlers* case. *See Teamsters Nat'l Freight Indus. Negotiating Comm. v. U.S. Truck Co. (In re U.S. Truck Co.)*, 800 F.2d 581 (6th Cir. 1986), *and Official Creditors' Comm. ex rel. Class 8 Unsecured Creditors v. Potter Material Serv., Inc. (In re Potter Material Serv., Inc.)*, 781 F.2d 99 (7th Cir. 1986). Both decisions assumed without deciding that the new value exception survived under the Bankruptcy Code. Since the *Ahlers* decision, the Seventh Circuit has issued a pair of directly conflicting opinions in *Kham & Nate's*, 908 F.2d 1351 (7th Cir. 1990) (Easterbrook, J.) (questioning continuing vitality of exception in dicta), and *Snyder v. Farm Credit Bank of St. Louis (In re Snyder)*, 967 F.2d 1126 (7th Cir. 1992) (Cudahy, J.) (defending exception in dicta).[6]

In late 1991, the Fifth Circuit flatly rejected the new value exception in part IV of its decision in *Greystone III Joint Venture*, 948 F.2d 134, 142-44 (5th Cir. 1991), which was intended to give guidance to the bankruptcy court on remand. The Fifth Circuit withdrew that part of its decision four months later, apparently in response to this Court's decision in the *Dewsnup* case. *See* 995 F.2d 1274, 1284-85. Judge Edith Jones, the author of the original decision, dissented from withdrawal of the new value exception portion of the decision: "I would hope to stand with Galileo, who, rebuffed by a higher temporal authority, muttered under his breath, 'Eppur si muove.' ('And yet it moves.')" *Id.* at 1285.

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[6] A third decision of the Seventh Circuit, *In re Stegall*, 865 F.2d 140 (7th Cir. 1989), applied the exception to a new value plan but expressly recognized that the survival of the exception was an open question.

In April 1992, the Fourth Circuit questioned the vitality of the new value exception and rejected a new value plan which gave the debtor's old equityholders the exclusive right to contribute new capital to the reorganized debtor without exposing the debtor's property to the market or giving other parties in interest the opportunity to bid for it. *Travelers Ins. Co. v. Bryson Properties, XVIII (In re Bryson Properties, XVIII)*, 961 F.2d 496 (4th Cir.), *cert. denied*, ___ U.S. ___, 113 S. Ct. 191, 121 L. Ed. 2d. 134 (1992). "[E]ven if some limited new capital exception were viable under the Bankruptcy Code, it would not be so expansive as to apply under the facts of this case." 961 F.2d at 505.

While the Fourth Circuit's decision in *Bryson Properties* does not definitively reject the new value exception, it does appear irreconcilable with the Ninth Circuit's decision in this case on the critical issue whether equityholders receive property "on account of" their prior interest in the debtor under new value plans that do not afford other parties an opportunity to participate in the reorganized debtor on an equal footing. *Compare* Appendix A43-51 (old equityholders receive property in exchange for new value) *with* 961 F.2d 504-05 & n.14 (old equityholders' exclusive right under plan to contribute new value constitutes property received or retained on account of old interests).

Finally, both the Eighth and the Tenth Circuits have let stand, without addressing the viability of the new value exception, Bankruptcy Court decisions repudiating the exception in *Lumber Exch. Ltd. Partnership v. The Mut. Life Ins. Co. of N.Y. (In re Lumber Exch. Ltd. Partnership)*, 125 B.R. 1000 (Bankr. D. Minn.), *aff'd on other grounds*, 134 B.R. 354 (D. Minn. 1991), *aff'd*, 968 F.2d 647 (8th Cir. 1992), and *In re Drimmel*, 108 B.R. 284 (Bankr. D. Kan. 1989), *aff'd*, 135 B.R. 410 (D. Kan. 1991), *aff'd on other grounds sub nom. Unruh v. Rushville State Bank of Rushville, Mo.*, 987 F.2d 1506 (10th Cir. 1993).

The uncertainty and conflict inherent in these decisions of the Courts of Appeal are reflected in decisions of the Bankruptcy Courts

and District Courts, some of which have squarely embraced or rejected the new value exception. Among the recent cases which have held that the new value exception survived enactment of the Bankruptcy Code are: *Prudential Ins. Co. v. F.A.B. Indus. (In re F.A.B. Indus.)*, 147 B.R. 763 (C.D. Cal. 1992), *appeal docketed*, No. 93-55055 (9th Cir. Jan. 13, 1993); *In re Sovereign Group 1985-27, Ltd.*, 142 B.R. 702 (E.D. Pa. 1992); *In re Montgomery Court Apartments, Ltd.*, 141 B.R. 324 (Bankr. S.D. Ohio 1992); *In re SLC Ltd. V*, 137 B.R. 847 (Bankr. D. Utah 1992); and *Penn Mutual Life Ins. Co. v. Woodscape Ltd. Partnership (In re Woodscape Ltd. Partnership)*, 134 B.R. 165 (Bankr. D. Md. 1991). Among the lower court decisions, in addition to those cited in the previous paragraph, which have rejected the new value exception are: *First Republic Thrift & Loan of San Diego v. Triple R Holdings, L.P. (In re Triple R Holdings, L.P.)*, 145 B.R. 57 (N.D. Cal. 1992) (adopting the reasoning set forth in *In re Outlook/Century Ltd.*, 127 B.R. 650 (Bankr. N.D. Cal. 1991)); *Piedmont Assocs. v. CIGNA Property & Casualty Ins. Co.*, 132 B.R. 75 (N.D. Ga. 1991); *In re A.V.B.I., Inc.*, 143 B.R. 738 (Bankr. C.D. Cal. 1992); and *In re Winters*, 99 B.R. 658 (Bankr. W.D. Pa. 1989).

The question whether the new value exception survived enactment of the Bankruptcy Code has now been thoroughly debated by the courts, and new decisions appear to be lining up with earlier decisions, rather than offering new insights in their analysis of the issues. The passage of time therefore will likely defer, not facilitate, resolution of the issue posed by this case. The Ninth Circuit's prediction that the survival of the new value exception ultimately will have to be decided by this Court, *see supra* page 7, thus appears accurate.

CONCLUSION

Five years ago, this Court questioned the survival of the new value exception after enactment of the Bankruptcy Code, but reserved decision of the issue for another case. In the interim, the Courts of Appeal, District Courts and Bankruptcy Courts have produced a

significant number of conflicting decisions on this important but unsettled question of federal law. The Court of Appeals for the Ninth Circuit has now squarely decided in this case that the new value exception is a viable corollary to the Bankruptcy Code, unaltered by Congress' overhaul of the Bankruptcy Act.

The resolution of the issue in this case follows from a misinterpretation of Section 1129(b)(2)(B)(ii) of the Bankruptcy Code that conflicts with this Court's decision in *Ahlers* and the Fourth Circuit's decision in *Bryson Properties*. The decision below also misapplies the principles of Bankruptcy Code interpretation established by this Court in the line of cases commencing with *Midlantic*.

For the foregoing reasons, this Court should grant a writ of certiorari to the Court of Appeals for the Ninth Circuit to review its decision in this case and resolve the question whether the new value exception survived enactment of the Bankruptcy Code.

Respectfully submitted,

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In re BONNER MALL PARTNERSHIP, Debtor.
Bonner Mall Partnership,
Plaintiff-Appellee,

v.

U.S. BANCORP MORTGAGE CO.,
Defendant-Appellant.

No. 92-36754.

United States Court of Appeals,
Ninth Circuit.

Argued and Submitted March 2, 1993.
Decided Aug. 4, 1993.

Creditor moved for relief from the automatic stay and for dismissal of Chapter 11 debtor's case, alleging debtor's plan providing for preferential treatment of debtor's equity holders in exchange for additional capital contribution and real property was not confirmable as matter of law. The Bankruptcy Court, Alfred C. Hagan, Chief Judge, granted relief from the United States District Court for the District of Idaho, 142 B.R. 911, Harold L. Ryan, J., reversed and remanded, holding that the new value exception to the absolute priority rule survived enactment of Bankruptcy Code, and creditor appealed. The Court of Appeals, Reinhardt, Circuit Judge, held that: (1) bankruptcy court order granting relief from stay was final for appeal purposes, and (2) new value exception survived enactment of the Code.

Judgment of district court affirmed and remanded.

Bradford Anderson, Stoel, Rives, Boley, Jones & Grey, Seattle, WA (argued); Dale G. Higer, Stoel, Rives, Boley, Jones & Grey, Boise, ID (on briefs), for defendant-appellant.

Ford Elsaesser (argued), Barbara Buchanan (on briefs), Elsaesser, Jarzabek, Buchanan and Dressel, Sandpoint, ID, for plaintiff-appellee.

Appeal from the United States District Court for the District of Idaho.

Before: WRIGHT, CANBY, and REINHARDT, Circuit Judges.

REINHARDT, Circuit Judge:

This case requires us to decide whether the new value "exception" to the absolute priority rule survives the enactment of the Bankruptcy Reform Act of 1978 (better known as the Bankruptcy Code), which replaced the Bankruptcy Act of 1898.[1] The new value exception allows the shareholders of a corporation in bankruptcy to obtain an interest in the reorganized debtor in exchange for new capital contributions over the objections of a class of creditors that has not received full payment on its claims. Whether this doctrine is viable under the Bankruptcy Code has significant implications for the relative bargaining power of debtors and creditors in Chapter 11 cases. Although no circuit court has

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[1] We place quotation marks around the term "exception" because the label is a misnomer that has lead to significant confusion. However, due to the term's common usage, we shall employ it on some occasions. On others we shall use the more descriptive new value "doctrine" or "principle".

taken a definitive position on this question, dicta in several opinions demonstrate intra and inter-circuit disagreements. District and bankruptcy courts are sharply divided on the question, as are the commentators. The question will in all probability ultimately be decided by the Supreme Court. In the meantime, we conclude that the new value exception remains a vital principle of bankruptcy law.

I. BACKGROUND

In 1984-85, Northtown Investments built Bonner Mall. The project was financed by a $6.3 million loan, secured by the mall property, from First National Bank of North Idaho, which later sold the note and deed of trust to appellant U.S. Bancorp Mortgage Co. ("Bancorp"). In October 1986 the mall was purchased by appellee Bonner Mall Partnership ("Bonner"), subject to the lien acquired

by Bancorp. Bonner is composed of six partners, five trusts and one individual investor, and was formed for the express purpose of buying the mall. Unfortunately, the cash-flow from the mall was much smaller than Bonner expected. When Bonner failed to pay its real estate taxes to Bonner County, Idaho, Bancorp commenced a nonjudicial foreclosure action. After several unsuccessful attempts to renegotiate and restructure Bonner's debt, Bancorp set a trustee's sale for March 14, 1991.

On March 13, 1991, Bonner filed a Chapter 11 (reorganization) bankruptcy petition, which automatically stayed the foreclosure sale. 11 U.S.C. § 362(a). Bancorp moved for relief from the stay under section 362(d)(2).[2] As a condition

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[2] Bancorp also moved to dismiss the bankruptcy as a bad-faith filing. This motion was denied and no appeal has been taken.

to obtaining relief under that provision, Bancorp was required to show that Bonner had no equity in the mall and that Bancorp's claim against Bonner was undersecured. *United Sav. Ass'n of Tex. v. Timbers of Inwood Forest Assoc., Ltd.*, 484 U.S. 365, 377 108 S.Ct. 626, 633, 98 L.Ed.2d 740 (1988). Because Bancorp established these facts, the burden shifted to Bonner to prove 1) that its retention of the mall was necessary to an effective reorganization,[3] and 2) that there was a reasonable possibility of a successful reorganization within a reasonable time.[4] *See id.* After two hearings on Bancorp's motion, the

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[3] The bankruptcy court found that this was shown.

[4] In a § 362(d) proceeding the debtor need not demonstrate that its plan actually will be confirmed nor need it put forth the kind of evidence required at a confirmation hearing. *See John Hancock Mut. Life Ins. Co. v. Route 37 Business Park Assoc.*, 987 F.2d 154, 162 (3d Cir.1993). A debtor must, however, produce some evidence that its plan could be confirmed by a reasonable bankruptcy judge.

bankruptcy court denied it without prejudice. In his order denying relief the bankruptcy judge assumed the continued existence of the new value exception, noted its strict requirements, and expressed doubts whether Bonner could satisfy them. Nevertheless, he allowed Bonner thirty days to propose a plan.

Bonner filed a reorganization plan relying on the new value doctrine. In response Bancorp renewed its motion to lift the stay. Bancorp argued 1) that the new value exception did not survive the enactment of the Bankruptcy Code; and 2) even if it did, Bonner's plan was still unconfirmable as a matter of law. The parties stipulated that the motion involved only legal questions, so no evidence was taken. The bankruptcy court accepted Bancorp's first argument but did not reach the second. The bankruptcy judge noted that after his original order

the Fifth Circuit had concluded in its "convincing" decision in *Phoenix Mut. Life Ins. Co. v. Greystone III Joint Venture (In re Greystone III Joint Venture)*, 995 F.2d 1274 (5th Cir.1991), petition for rehearing granted in part and opinion withdrawn in part, 995 F.2d 1284 (5th Cir.) *(per curiam)*, *cert. denied*, --- U.S. ----, 113 S.Ct. 72, 121 L.Ed.2d 37 (1992), that there is no longer a new value exception. On that basis, the judge granted Bancorp's motion for relief from the automatic stay. After the bankruptcy judge stayed his order at Bonner's request, Bonner appealed to the district court.

On appeal, the district judge determined that the only issue before him was whether the Bankruptcy Code had eliminated the new value exception. He found that it had not. In doing so he relied on the Supreme Court's ruling in

Dewsnup v. Timm, --- U.S. ----, 112 S.Ct. 773, 116 L.Ed.2d 903 (1992), which was handed down after the bankruptcy court's decision and which emphasized the Court's reluctance to overturn pre-Code practice *(see infra)*. Moreover, by the time of the district court's opinion the relevant portion of the Fifth Circuit's *Greystone* opinion had been withdrawn.[5] The district court reversed the judgment of the bankruptcy court and remanded for further proceedings consistent with its opinion. 142 B.R. 911. It refused to address Bancorp's alternative argument that Bonner's plan was unconfirmable as a matter of law even if the new value exception survived. Instead, its order stated: "Confirmation of the plan

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[5] On petition for rehearing and after the Supreme Court's decision in *Dewsnup*, the majority of the *Greystone* panel deleted the entire new value exception discussion over Judge Edith Jones' vigorous dissent. *See* 995 F.2d at 1285. The majority stated that it was expressing "no view whatever" on the new value exception. *Id.*

proposed by the Debtor must be addressed by the bankruptcy court on remand." Bancorp filed a timely appeal to this court. Like the district court, we resolve only the question whether the new value exception survives.[6] The issue is one of law. Accordingly, our review is de novo. *See Home Sav. Bank, F.S.B. v. Gillam*, 952 F.2d 1152, 1156 (9th Cir.1991).

II. JURISDICTION

The parties agree that we have jurisdiction to hear Bancorp's appeal. Nevertheless, we have an independent duty to examine our own subject matter jurisdiction. *Pizza of Hawaii, Inc. v. Shakey's Inc. (In re Pizza of Hawaii, Inc.)*, 761 F.2d 1374, 1377 (9th Cir.1985). Twenty Eight U.S.C. section

[6] For the reasons set forth in section V *infra*, we do not reach the question whether Bonner's plan can satisfy the requirements of the exception.

158(d) provides that "[t]he courts of appeal shall have jurisdiction of appeals from all final decisions, judgments, orders, and decrees entered under subsections (a) and (b) of this section." Subsection (a) states in relevant part that: The district courts of the United States shall have jurisdiction to hear appeals from final judgments, orders, and decrees, and with leave of the court, from interlocutory orders, of bankruptcy judges entered in cases and proceedings referred to the bankruptcy judges under section 157 of this title. 28 U.S.C. § 158(a).[7] For us to have jurisdiction, both the bankruptcy court's and district court's orders must be final. *Allen v. Old Nat'l Bank of Wash (In re Allen)*, 896 F.2d 416, 418 (9th Cir.1990) *(per*

[7] The bankruptcy court had jurisdiction over Bancorp's motion under 28 U.S.C. §§ 157(b)(1) & (b)(2)(G). Therefore, the district court's appellate jurisdiction was properly invoked.

curiam). Here, the bankruptcy court's order granting relief from the automatic stay was clearly final.[8] *Packerland Packing Co. v. Griffith Brokerage Co. (In re Kemble)*, 776 F.2d 802, 805 (9th Cir.1985). Moreover, if Bancorp had foreclosed on the mall, Bonner's sole significant asset, for all intents and purposes the bankruptcy case would have ended; therefore, the bankruptcy court's order required immediate appellate review. *See Elliot v. Four Seasons Properties (In re Frontier Properties, Inc.)*, 979 F.2d 1358, 1363 (9th Cir.1992); *Allen*, 896 F.2d at 418.

The more difficult question is whether the district court's order was

[8] In his order granting Bonner a stay from his order lifting the automatic stay, the bankruptcy judge referred to his earlier action as interlocutory. That description is incorrect.

final.[9] The unique nature of bankruptcy procedure dictates that we take a pragmatic approach to finality. *Vylene Enter. Inc. v. Naugles (In re Vylene Enter. Inc.)*, 968 F.2d 887, 894 (9th Cir.1992); *Mason v. Integrity Ins. Co. (In re Mason)*, 709 F.2d 1313, 1318 (9th Cir.1983). Our cases hold that 28 U.S.C. section 158(d) affords a more liberal finality standard than does 28 U.S.C.

[9] One noted commentator has described circuit law regarding the finality of intermediate level decisions in bankruptcy proceedings as "hopelessly unresolved." 1 *Collier on Bankruptcy*, ¶ 3.03[6][b], 3-192 (Lawrence King, ed. 15th ed. 1992). The Third Circuit takes the view that where the bankruptcy court has issued an indisputably final order a district court decision affirming or reversing is also final because there is nothing further for the district court to do. *Official Unsecured Creditors Committee v. Michaels (In re Marin Motor Oil)*, 689 F.2d 445, 448-49 (3d Cir.1982), *cert. denied*, 459 U.S. 1207, 103 S.Ct. 1196, 75 L.Ed.2d 440 (1983). Other circuits adhere to a rule that a district court decision reversing and remanding is not final where the bankruptcy court will conduct significant further proceedings. *E.g., In re G.S.F. Corp.*, 938 F.2d 1467, 1472 (1st Cir.1991); *Suburban Bank of Cary Grove v. Riggsby (In re Riggsby)*, 745 F.2d 1153, 1155 (7th Cir.1984); *Homa v. Stone (In re Commercial Contractors, Inc.)*, 771 F.2d 1373, 1375 (10th Cir.1985). As discussed *infra* we have charted a middle-course between these positions.

section 1291.[10] *Vylene*, 968 F.2d at 893-94.[11]

Under Ninth Circuit law, if the district court affirms or reverses a final bankruptcy court order, its order is final. *King v. Stanton (In re Stanton)*, 766 F.2d 1283, 1287 (9th Cir.1985). However, difficult questions

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[10] One of the reasons for this distinction is that by definition the decisions we review under § 158(d) are those of another court (whether a district court or a bankruptcy appellate panel) acting in an appellate capacity. In most situations a decision we review under § 1291 is that of a district court (or jury) sitting nisi prius as the factfinder. The rules of finality are designed, in part, to preserve the integrity of the factfinding process. This interest is not at stake in the case of an intermediate level decision in a bankruptcy proceeding. We review de novo all decisions of bankruptcy appellate panels and district courts in cases that come to us by way of § 158(d). *See Briggs v. Kent (In re Professional Inv. Properties of Am.)*, 955 F.2d 623, 626 (9th Cir.), *cert. denied*, --- U.S. ----, 113 S.Ct. 63, 121 L.Ed.2d 31 (1992).

[11] In *Vylene* we raised the possibility that our decisions which hold that the finality requirements of § 1291 in the bankruptcy context are more stringent than those imposed by § 158(d) might be inconsistent with the "implications" of *Connecticut Nat. Bank v. Germain*, --- U.S. ----, 112 S.Ct. 1146, 1149, 117 L.Ed.2d 391 (1992). *See* 968 F.2d at 891-94. We need not address that question here except to note that nothing in *Germain* casts doubt upon the liberal standard for finality we have adopted regarding § 158(d).

regarding finality sometimes arise when a district court reverses a final order of a bankruptcy court and remands. *Vylene*, 968 F.2d at 895. In such circumstances we balance two important policies: avoiding piecemeal appeals and enhancing judicial efficiency. *Id.*; *Zolg v. Kelly (In re Kelly)*, 841 F.2d 908, 911 (9th Cir.1988). We also consider the systemic interest in preserving the bankruptcy court's role as the finder of fact. *Stanton*, 766 F.2d at 1287.[12] On the basis of our analysis of these factors, we have concluded that when the district court remands for further factual findings related to a central issue

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[12] We have also considered whether delaying review might cause irreparable harm to a substantive right of the party that lost in the district court. *E.g.*, *Vylene*, 968 F.2d 895-96. Delayed review in this case, however, would not cause irreparable harm to Bancorp; it would face only the prospect of unnecessarily litigating the merits of Bonner's reorganization plan in the bankruptcy court. *See Frontier Properties*, 979 F.2d at 1363 (impact upon litigation strategy and necessity of additional litigation are not irreparable harms).

raised on appeal, its order is ordinarily not final and we lack jurisdiction. *Id.* at 1286.

However, *Stanton* suggests that we should assert jurisdiction even though a district court has remanded a matter for factual findings on a central issue if that issue is legal in nature and its resolution either 1) could dispose of the case or proceeding and obviate the need for factfinding;[13] or 2) would materially aid the bankruptcy court in reaching its disposition on remand. 766 F.2d at 1288 n. 8; *see also Farm Credit Bank of Spokane v. Fowler (In re Fowler)*,

[13] In *Stanton* we imprecisely used the word "would" rather than "could" in the foregoing clause and thereby implied that we should assert jurisdiction under this exception only if we knew that our decision on the merits would obviate the need for further factfinding. Ordinarily, we must resolve the question of our jurisdiction before determining the merits of a case. Therefore, the *Stanton* suggestion applies where a decision in favor of one of the parties as to a central legal issue in the case would eliminate the necessity of factual findings on remand, regardless of our eventual ruling.

903 F.2d 694, 696 (9th Cir.1990) (citing second *Stanton* criterion with approval). We believe that the *Stanton* principle is sound and we adopt it here. The present case falls squarely within the first *Stanton* criterion. The central question is a legal one that is clearly potentially dispositive. It involves the very existence of the rule pursuant to which the bankruptcy court would be required to make factual findings on remand. If we hold that the new value exception no longer exists, no further factual proceedings will be necessary and Bancorp will be entitled to the relief it seeks as a matter of law.

The instant case presents a situation analogous to the one we faced in *Pizza of Hawaii*, which was cited with approval in *Stanton* and *Fowler*. In *Pizza of Hawaii* the bankruptcy court confirmed Pizza's proposed plan (a final order)

over Shakey's objection that the plan did not make sufficient provision for a debt that Pizza might owe Shakey's on account of a pending civil case. On appeal, the district court 1) vacated the order of confirmation; 2) ordered the bankruptcy court to grant Shakey's leave to amend its proof of claim; 3) ordered the bankruptcy court to value the claim; and 4) ordered the bankruptcy court to reconsider the plan's feasibility in light of the value of Shakey's claim. 761 F.2d at 1376. Pizza appealed the order to this court. Despite the fact that the district court had remanded for proceedings of a factual nature, we held that we had jurisdiction. 761 F.2d at 1378, 1382. Here, as in *Pizza of Hawaii*, the policy of judicial economy, which militates in favor of our asserting jurisdiction, strongly outweighs the need to avoid piecemeal appeals.

For the above reasons, we conclude that we have subject matter jurisdiction over Bancorp's appeal under 28 U.S.C. section 158(d).

III. BONNER'S PLAN, CONFIRMATION, AND THE NEW VALUE EXCEPTION

Bonner's proposed reorganization plan ("the Plan") provides for the transfer of all of Bonner Mall Partnership's assets (the mall for all practical purposes) to a new corporation, Bonner Mall Properties, Inc., created by the Plan to carry out its provisions. One of the most significant features of the Plan is the treatment of Bancorp's $6.6 million claim, for which the mall is collateral. In the course of his original order denying Bancorp's motion for relief from the stay, the bankruptcy judge valued the mall at $3.2 million. This meant that Bancorp's claim against Bonner was undersecured: it was secured

as to \$3.2 million and unsecured as to \$3.4 million. *See* 11 U.S.C. § 506(a). The unsecured portion of Bancorp's claim represents the vast majority of Bonner's unsecured debt. Under the Plan, the \$3.2 million debt to Bancorp secured by the mall would be paid 32 months after the Plan's confirmation, with interest payments payable monthly in the interim. Payment of all other secured debt would be deferred. All unsecured creditors of Bonner who are owed more than \$1000 would be paid according to a pro-rata distribution of 300,000 shares of preferred stock in the new corporation. Each share would be valued at \$1.00.[14] The preferred stock would be convertible to a maximum of 300,000 shares of common

[14] Thus, Bancorp would receive less than ten cents on the dollar in preferred stock for its unsecured claim.

stock once Bonner paid off the secured part of Bancorp's claim.

Under the Plan the equity owners, i.e. the partners, would receive nothing on their claims. However, to raise additional capital for the new corporation, the partners would contribute a total of \$200,000 in cash to Bonner Mall Properties in exchange for 2 million of the 4 million authorized shares of the new corporation's common stock. No other persons are designated to receive stock in exchange for such contributions. The Plan also states that the partners would subsidize any shortfall in working capital during the first 32 months after confirmation of the plan.[15] Moreover, the trustee for the five trust-partners of Bonner Mall Partnership is to contribute a collateral

[15] Bancorp questions whether this is a binding obligation under the terms of the plan.

trust mortgage on a 4500-acre property as a guarantee of payment of the debts assumed by Bonner Mall Properties.[16] In exchange, the new corporation is to service part of the trustee's debt on the property.

Section 1129(a) of Chapter 11 establishes thirteen requirements for confirmation of a reorganization plan, all of which must generally be satisfied. One such requirement is set forth in subsection (a)(8), which mandates that "[w]ith respect to each class [of claims], A) such class has voted to accept the plan or B) such class is not impaired under the plan." 11 U.S.C. § 1129(a)(8).[17] Under Bonner's Plan all

[16] Bonner claims the property's fair market value is $4.5 million, with equity of approximately $2 million. These figures are disputed. Bancorp states that the property is the subject of a state court foreclosure proceeding.

[17] A class is deemed to have accepted a plan if at least two-thirds in amount and more than (continued...)

claim classes are impaired and, therefore, all must accept the plan for a consensual confirmation. It is a foregone conclusion that at least the unsecured class of which Bancorp is the principal member will vote not to confirm the plan in view of the minimal return Bancorp will receive on the unsecured fraction of its claim.

However, the Code provides that where all requirements for confirmation but section 1129(a)(8) are met, the bankruptcy court shall confirm a Chapter 11 reorganization plan over the objection of an impaired class or classes "if the plan does not discriminate unfairly, and is fair and equitable, with respect to each class of claims or interests that is

[17](...continued) one-half in number of claims in the class vote to accept it. § 1126(c). A class is impaired if the plan does not provide it with full payment in cash of its claims on the date the plan becomes effective. § 1124(3)(A).

impaired under, and has not accepted, the plan." 11 U.S.C. § 1129(b)(1) (emphasis added). This form of confirmation is commonly known in bankruptcy parlance as a "cramdown" because the plan is crammed down the throats of the objecting class(es) of creditors. The issue before the bankruptcy judge in deciding whether to grant Bancorp's motion for relief from the stay was whether Bonner's Plan had a reasonable possibility of confirmation in a cramdown, i.e., whether the standards set forth in section 1129(b)(1) could feasibly be satisfied.

The resolution of this question turns on whether there is a reasonable possibility that a bankruptcy judge could find Bonner's Plan "fair and equitable." Section 1129(b)(2) of the Code defines "fair and equitable" as including several enumerated requirements. The section, which is at the heart of the controversy

between the parties, states, *inter alia*, that a plan will be considered "fair and equitable" only if: (B) With respect to a class of unsecured claims-- (i) the plan provides that each holder of a claim of such class receive or retain on account of such claim property of a value, as of the effective date of the plan, equal to the allowed amount of such claim; or (ii) the holder of any claim or interest that is junior to the claims of such class will not receive or retain under the plan on account of such junior claim or interest any property. (emphasis added). Section 1129(b)(2)(B) is a two-part codification of the judge-made absolute priority rule, compliance with which was a prerequisite to any determination that a plan was "fair and equitable" under the Bankruptcy Act.

Here, each of the unsecured claims against Bonner will not be paid in full

on the effective date of the Plan. As a result, section 1129(b)(2)(B)(i) cannot be satisfied. Therefore, Bonner's Plan cannot be held to be "fair and equitable" unless it complies with the provisions of section 1129(b)(2)(B)(ii). If it fails to meet the requirements of that section it is unconfirmable as a matter of law. A critical area of dispute in this case is whether Bonner's Plan violates section 1129(b)(2)(B)(ii) and, in turn, the absolute priority rule and the "fair and equitable" principle.

Under pre-Code Bankruptcy Act practice, a plan that allowed stockholders in the business that had filed for bankruptcy protection (old equity) to receive stock in the reorganized debtor in exchange for contributions of added capital (new value) could under certain conditions satisfy the absolute priority rule and be

considered "fair and equitable" even though a senior class was not paid in full. *See Case v. Los Angeles Lumber Products Co.*, 308 U.S. 106, 121, 60 S.Ct. 1, 10, 84 L.Ed. 110 (1939); *Marine Harbor Properties, Inc. v. Manufacturers Trust Co.*, 317 U.S. 78, 85-86, 63 S.Ct. 93, 97-98, 87 L.Ed. 64 (1942); *Mason v. Paradise Irrigation Dist.*, 326 U.S. 536, 541-43, 66 S.Ct. 290, 292-93, 90 L.Ed. 287 (1946). That set of conditions became known collectively as the "new value exception" to the absolute priority rule; the terms of that "exception" will be discussed below.

Although the question we must ultimately answer is whether the new value exception survived the enactment of the Bankruptcy Code, we should note, preliminarily, that the term "exception" is misleading. The doctrine is not

actually an exception to the absolute priority rule but is rather a corollary principle, or, more simply a description of the limitations of the rule itself. It is, as indicated above, the set of conditions under which former shareholders may lawfully obtain a priority interest in the reorganized venture. The Supreme Court appeared to recognize as much in *Case v. Los Angeles Lumber* when it stated that if a new capital contribution satisfies certain conditions "the creditor cannot complain that he is not accorded full right of priority against the corporate assets." 308 U.S. at 122, 60 S.Ct. at 10 (internal quotation omitted). More properly, the new value exception should be called something like the "new capital-infusion doctrine" or as one commentator has suggested, "the scrutinize old equity participation rule." Elizabeth Warren,

A Theory of Absolute Priority, 1991 Annual Survey of American Law 9, 42.

The question whether the adoption of the Code served to eliminate the new value exception was before the Supreme Court in *Norwest Bank Worthington v. Ahlers*, 485 U.S. 197, 108 S.Ct. 963, 99 L.Ed.2d 169 (1988). While there is language in the opinion questioning the viability of the doctrine, the Court explicitly stated that it was not deciding the issue.[18] Instead, the Court assumed that the doctrine existed but found that all of its requirements were not satisfied under the facts of that case. Since *Ahlers*[19] several court of

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[18] "Our decision today should not be taken as any comment on the continuing vitality of the *Los Angeles Lumber* exception." *Norwest Bank v. Ahlers*, 485 U.S. at 203 n. 3, 108 S.Ct. at 967 n. 3. The Solicitor General had filed an amicus brief asking the Court to rule that the new value exception was defunct. *Id.*

[19] Prior to *Ahlers* the Sixth and Seventh Circuits both applied the new value exception in confirming reorganization plans in cases arising (continued...)

appeals have avoided a direct holding on the viability of the "exception" by using the same stratagem.[20]

Other appellate courts have given mixed signals on whether the principle survives. The Seventh Circuit seems internally divided on the question: In one case it analyzed a reorganization plan in light of the exception, while stating that the status of the doctrine is an open question after *Ahlers*; another

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[19](...continued) under the Code. *Teamsters Nat. Freight Indus. Negotiating Comm. v. U.S. Truck Co. (In re U.S. Truck Co.)*, 800 F.2d. 581, 588 (6th Cir.1986); *Official Creditors' Comm. ex rel. Class 8 Unsecured Creditors v. Potter Material Serv., Inc. (In re Potter Material Serv., Inc.)*, 781 F.2d. 99, 101 (7th Cir.1986). These opinions appear to have assumed the vitality of the doctrine without explicitly addressing the issue. While the Seventh Circuit's later jurisprudence in this area is confused *(see infra)*, the Sixth Circuit has never questioned the viability of *U.S. Truck*. Indeed, bankruptcy courts of the Sixth Circuit have adhered to *U.S. Truck* as controlling precedent since *Ahlers*. *See e.g., In re Montgomery Court Apartments, Ltd.*, 141 B.R. 324, 343 (Bankr. S.D.Ohio1992); *In re Professional Dev. Corp.*, 133 B.R. 425, 428 (Bankr.W.D.Tenn.1991).

[20] *E.g., Unruh v. Rushville State Bank of Rushville, Mo.*, 987 F.2d 1506 (10th Cir.1993); *Anderson v. Farm Credit Bank of St. Paul (In re Anderson)*, 913 F.2d 530 (8th Cir.1990).

panel criticized the exception and strongly hinted that it is moribund; and a third stopped just short of holding that the exception survives.[21] The Fourth Circuit has suggested that if the new value exception exists it is narrow in scope.[22] Our own Bankruptcy Appellate Panel has recognized the continued existence of the exception. *See Carson Nugget, Inc. v. Green (In re Green)*, 98 B.R. 981, 982 (BAP 1989) *(per curiam)*.

While there is a division in the district and bankruptcy courts of our circuit and nationwide, the majority of courts that have considered the question have held that the new value exception is

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[21] *See In re Stegall*, 865 F.2d 140, 141-44 (7th Cir.1989); *Kham & Nate's Shoes No. 2, Inc. v. First Bank of Whiting*, 908 F.2d 1351, 1359-62 (7th Cir.1990); *Snyder v. Farm Credit Bank of St. Louis (In re Snyder)*, 967 F.2d 1126, 1128 (7th Cir.1992).

[22] *Travelers Ins. Co. v. Bryson Properties, XVIII, (In re Bryson Properties, Inc., XVIII)*, 961 F.2d. 496, 503-05 (4th Cir.), *cert. denied*, --- U.S. ----, 113 S.Ct. 191, 121 L.Ed.2d 134 (1992).

alive and well. We share the view that the doctrine remains a vital legal principle. Accordingly, we hold that the Code permits the confirmation of a reorganization plan that provides for the infusion of capital by the shareholders of the bankrupt corporation in exchange for stock if the plan meets the conditions that plans were required to meet prior to the Code's adoption.

IV. THE NEW VALUE EXCEPTION AND THE CODE

Our explanation of why we hold that the new value exception survives will address several distinct but related issues. First, we determine that the Code provision codifying the absolute priority rule does not prohibit confirmation of a new value plan. Second, we decide that Congress' failure expressly to include the new value doctrine as a standard to be considered in applying the "fair and equitable"

principle does not reflect an intent to eliminate the exception. Finally, we conclude that the new value exception is fully consistent with the structure and underlying policies of Chapter 11.

A. The Codification of the Absolute Priority Rule Does Not Serve to Eliminate the New Value Exception.

The parties take diametrically opposed positions as to the consistency of the new value exception with 11 U.S.C. section 1129(b)(2)(B)(ii). Bancorp argues that: 1) Bonner's Plan violates the absolute priority rule because the old equity owners will have an ownership interest in the new company even though Bancorp's unsecured claim will not be paid in full and 2) the plain meaning of 11 U.S.C. section 1129(b)(2)(B)(ii) demonstrates that the new value exception did not survive the enactment of the Code. Bonner contends that: 1) the

infusion of new capital from a source outside the bankruptcy estate, even if the source is a former equity holder, is an independent act that does not violate the absolute priority rule and 2) section 1129(b)(2)(B)(ii) does not forbid confirmation of plans that meet the requirements of the new value exception.

In determining whether section 1129(b)(2)(B)(ii) abolishes the new value exception we apply the traditional tools of statutory construction. The interpretation of a statutory provision must begin with the plain meaning of its language. *Pennsylvania Public Welfare Dept. v. Davenport*, 495 U.S. 552, 557, 110 S.Ct. 2126, 2130, 109 L.Ed.2d 588 (1990). Where statutory language is unambiguous the judicial inquiry is complete. *Connecticut Nat. Bank v. Germain*, --- U.S. ----, ----, 112 S.Ct. 1146, 1149, 117 L.Ed.2d 391 (1992).

It is a cardinal principle of statutory construction that a court must give effect, if possible, to every clause and word of a statute. *Negonsott v. Samuels*, --- U.S. ----, ----, 113 S.Ct. 1119, 1123, 122 L.Ed.2d 457 (1993). When the statutory scheme is coherent and consistent, there generally is no need for a court to inquire beyond the plain language. *United States v. Ron Pair Enterp., Inc.*, 489 U.S. 235, 240-41, 109 S.Ct. 1026, 1029-30, 103 L.Ed.2d 290 (1988). Applying these familiar rules, we conclude that the plain language of section 1129(b)(2)(B)(ii) demonstrates that Bonner's, and not Bancorp's, reading of the provision is correct.

1. Because Qualifying New Value Plans Do Not Give Old Equity Holders Stock in the Reorganized Debtor "On Account Of" Their Prior Ownership

Interests, They Do Not Violate 11 U.S.C. Section 1129(b)(2)(B)(ii).

Eleven U.S.C. section 1129(b)(2)(B)(ii) requires that a plan provide that with respect to a class of unsecured claims that has not received full payment--

> the holder of any claim or interest that is junior to the claims of such class will not receive or retain under the plan *on account of such junior claim or interest* any property.

(emphasis added) In plainer English the provision bars old equity from receiving any property via a reorganization plan "on account of" its prior equitable ownership when all senior claim classes are not paid in full. *E.g., Snyder v. Farm Credit Bank of St. Louis (In re Snyder)*, 967 F.2d 1126, 1130 (7th Cir.1992); *Teamsters Nat'l Freight Indus. Negotiating Comm. v. U.S. Truck Co. (In re U.S. Truck Co.)*, 800 F.2d 581, 588

(6th Cir.1986); *Prudential Ins. Co. v. F.A.B. Indus. (In re F.A.B. Indus.)*, 147 B.R. 763, 768-69 (C.D.Cal.1992), *appeal docketed*, No. 93-55055 (9th Cir. Jan. 13, 1993); *In re Pullman Construction Indus*, 107 B.R. 909, 944 (N.D.Ill.1989). The central inquiry in determining the reach of the prohibition is the meaning of the critical words "on account of".

We have no difficulty in reconciling the "on account of" language with the new value exception. Under Bankruptcy Act practice, old equity was required to meet several requirements in order to take advantage of that doctrine. Former equity owners were required to offer value that was 1) new, 2) substantial, 3) money or money's worth, 4) necessary for a successful reorganization and 5) reasonably equivalent to the value or interest received. *Case v. Los Angeles Lumber*, 308 U.S. at 121-22, 60 S.Ct. at

10-11; *Snyder*, 967 F.2d at 1131. Several courts have concluded that if a proposed plan satisfies all of these requirements, i.e. the new value exception, it will not violate section 1129(b)(2)(B)(ii) of the Code and the absolute priority rule. Such a plan, they reason, will not give old equity property "on account of" prior interests, but instead will allow the former owners to participate in the reorganized debtor on account of a substantial, necessary, and fair new value contribution. *E.g.*, *U.S. Truck*, 800 F.2d at 588; *The Penn Mutual Life Ins. Co. v. Woodscape Ltd. Partnership (In re Woodscape Ltd. Partnership)*, 134 B.R. 165, 168, 172-74 (Bankr.D.Md.1991). We agree with their analysis.

We recognize that in some larger sense the reason that former owners receive new equity interests in reorganized ventures is that they are

former owners. But it is also true that in new value transactions old equity owners receive stock in exchange for the additional capital they invest. Causation for any event has many and varied levels. Here, the answer to the meaning of the phrase "on account of" lies in the level of causation Congress had in mind when it prohibited old equity owners from receiving property "on account of" their prior interests. A reading of the full text of section 1129(b)(2)(B)(ii) makes it clear that what Congress had in mind was direct or immediate causation rather than a more remote variety, and that it did not intend to prohibit persons who receive stock because they have provided new capital from becoming participants in the reorganized debtor simply because they

were also owners of the original enterprise.[23]

Had Congress intended that old equity never receive any property under a reorganization plan where senior claim classes are not paid in full, it could simply have omitted the "on account of" language from section 1129(b)(2)(B)(ii). We would then be left with an absolute prohibition against former equity owners' receiving or retaining property in the reorganized debtor in such circumstances. The expansive reading of the phrase "on account of such junior claim or interest" suggested by Bancorp would lead to the

[23] Professor Warren has stated: The Code does not prohibit old equity from becoming a post-petition financer of the business or a post-plan owner of the business. The Code leaves old equity in the same position as any other potential investor: it may offer to buy any of the assets of the estate on the same terms as any other buyer. *A Theory of Absolute Priority* at *39*. *Accord* Raymond T. Nimmer, *Negotiating Bankruptcy Reorganization Plans: Absolute Priority and New Value Contributions*, 36 Emory L.J. 1009, 1051 (1987); Bruce A. Markell, *Owners, Auctions and Absolute Priority in Bankruptcy Reorganizations*, 44 Stan.L.Rev. 69, 96-102 (1991)

identical result, thus rendering the disputed phrase superfluous. Under that interpretation any distribution to old equity would always be "on account of" its former interest in some sense. We decline Bancorp's invitation to nullify Congress' deliberate use of the term "on account of such junior claim or interest", particularly since nearly identical language can be found throughout the Code.[24] Congress must have intended the "on account of" language to have some significant meaning as well as some particular limiting effect.

We believe that Congress intended the "on account of" phrase in section 1129(b)(2)(B)(ii) to require bankruptcy courts to determine whether a

[24] For example, section 1129 alone uses a variant of the "on account of such claim or interest" language seven times.

reorganization plan that gives stock to former equity holders does so primarily because of their old interests in the debtor or for legitimate business reasons. The new value doctrine provides the means by which a court can discover whether a particular new capital transaction is proposed "on account of" old equity's prior ownership or "on account of" its new contribution. In other words, in evaluating whether a reorganization plan satisfies the requirements of the new value exception a court is in fact determining whether old equity is unjustifiably attempting to retain its corporate ownership powers in violation of the absolute priority rule or whether there is genuine and fair exchange of new capital for an equity interest.

Contrary to Bancorp's contentions, section 1129(b)(2)(b)(ii) does not by its

terms eliminate, or even refer to, the new value exception.[25] Rather, the language of that section and the requirements of the new value principle complement each other. Consequently, the fact that a reorganization plan provides for a new value transaction does not in and of itself violate 11 U.S.C. section 1129(b)(2)(B)(ii) and the absolutely priority rule.

2. The "On Account Of" Language of Section 1129(b)(2)(B)(ii) Does Not Bar Plans That Give Old Equity Alone the Opportunity to Acquire Stock for a New Capital Contribution.

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[25] We agree with the *Woodscape* court that a textual search for a "new value exception" to the absolute priority rule dictates its own negative result because such a statutory exception does not exist. 134 B.R. at 173. As we have explained, the new value principle is an extra-statutory doctrine that specifically regulates the conditions under which plans calling for an infusion of capital by old equity in exchange for participation in the reorganized debtor may be confirmed in a cramdown. *See also F.A.B.*, 147 B.R. at 768-69 (quoting amicus brief submitted by Professor Elizabeth Warren). A qualifying new value plan simply does not violate the absolute priority rule.

As Bancorp notes, several courts have held that where a reorganization plan gives old equity alone the right to obtain an interest in the reorganized debtor in exchange for new value, as Bonner's Plan does, the old equity holders are given "property" on account of their prior ownership interests and the absolute priority rule is violated. The Fourth Circuit held that such plans violate section 1129(b)(2)(B)(ii), even assuming the new value exception still exists. *Travelers Ins. Co. v. Bryson Properties, XVIII (In re Bryson Properties, XVIII)*, 961 F.2d 496, 504 (4th Cir.), *cert. denied*, --- U.S. ----, 113 S.Ct. 191, 121 L.Ed.2d 134 (1992);[26]

[26] In *Bryson* the Fourth Circuit seemed to find the fact that the debtor has the exclusive right to File a plan within 120 days of the order allowing it to proceed under Chapter 11 relevant to the validity of the plan under consideration. *Id.* at 504. The debtor receives this exclusive opportunity, which may be enlarged or shortened by the bankruptcy judge upon notice for cause, by operation of law. 11 U.S.C. § 1121(b)-(c). We do
(continued...)

see also In re A.V.B.I., Inc., 143 B.R. 738, 740-41 (Bankr.C.D.Cal.1992) (holding new value exception does not survive the Code); *In re Outlook/Century Ltd.*, 127 B.R. 650, 654 (Bankr.N.D.Cal.1991); *Lumber Exchange Ltd. Partnership v. The Mut. Life Ins. Co. of N.Y. (In re Lumber Exchange Ltd. Partnership)*, 125 B.R. 1000, 1008 (Bankr.D.Minn.), *aff'd*, 134 B.R. 354 (D.Minn. 1991), *aff'd*, 968 F.2d 647 (8th Cir.1992). Under this analysis the "property" given to old equity in violation of the absolute priority rule is not the stock in the reorganized debtor received in exchange for a new

[26](...continued)
not believe that this exclusivity period, which did not exist under the Act, makes the new value exception objectionable under the Code. Any party in interest may file a plan 1) if the debtor has not done so within the 120 days; 2) or if that plan is not accepted within 180 days of the order for relief under Chapter 11. 11 U.S.C. § 1121(c). Any proposed reorganization plan may take advantage of the new value principle. Moreover, in this case Bonner filed its plan after the exclusivity period had expired. Therefore, Bancorp had the ability to propose a competing plan if it so desired.

value contribution. Rather "[the] exclusive right of [the] Debtor's existing partners to obtain equity interests in [the] Debtor itself constitutes property that the partners retain 'on account of' their existing interests." *Outlook/Century*, 127 B.R. at 654 (emphasis added).

We disagree with this analysis. Even assuming that an exclusive opportunity is "property",[27] it does not follow that such an opportunity is property received or retained "on account of" old equity's prior ownership interests in the debtor. A proposed reorganization plan may give old equity

[27] The definition of "property" under the Code is extremely broad and includes intangible property. *Ahlers*, 485 U.S. at 208, 108 S.Ct. at 969. However, the exclusivity of the opportunity to purchase stock is irrelevant. Even if specified creditors and outside investors were given the opportunity to purchase stock for new value as well, old equity would still be given something of value which may be described as "property". A stock purchase option is property whether or not other people are also given such an option. See *Kham & Nate's Shoes*, 908 F.2d at 1360.

the exclusive opportunity to purchase stock in exchange for new capital for other reasons.[28] Exclusivity may be given because the plan proponent may believe that the participation of old equity in the new business will enhance the value of the business after reorganization. It is possible the debtor will conclude that additional funding will be easier to obtain if the old owners, the most likely investors, know in advance that their partners will all be familiar faces. Even more important, it may be apparent to the proponents of the plan that there will be no other legitimate investors who would be willing to put substantial capital into a business that is just emerging

[28] In theory, a reorganization plan could give the exclusive opportunity to receive stock in exchange for a new value contribution to anybody. For reasons that may sometimes be valid and sometimes not it will usually be the old owners.

from Chapter 11 protection.[29] As the Supreme Court has stated "[g]enerally, additional funds will be essential to the success of the undertaking, and it may be impossible to obtain them unless stockholders are permitted to contribute and retain an interest sufficiently valuable to move them." *Kansas City Terminal Ry. Co. v. Central Union Trust Co.*, 271 U.S. 445, 455, 46 S.Ct. 549, 522, 70 L.Ed. 1028 (1926); *accord Mason v. Paradise Irrigation Dist.*, 326 U.S. 536, 541-43, 66 S.Ct. 290, 292-93, 90 L.Ed. 287 (1946) (new money may not be available unless there is a "strong inducement"). The proponent of a plan may have good reason to believe that old

[29] This situation may occur with greater frequency in cases, such as the present one, involving single asset commercial real estate bankruptcies. In many parts of the country a depressed commercial real estate market will make these investments unattractive.

equity would not participate without the incentive of an exclusive opportunity.

As stated earlier, whether a particular plan gives old equity a property interest "on account of" its old ownership interests in violation of the absolute priority rule or for another, permissible reason is a factual question. The answer depends upon whether the requirements of the new value exception are met. We believe that this same analysis applies whether a plan gives old equity an exclusive or non-exclusive right of participation in a new value transaction. What matters instead is whether the proposed transaction meets the criterion "necessary to the success of the reorganization".[30] In other

[30] *Case v. Los Angeles Lumber* does not require that old equity be the only source of new capital for its contribution to meet this test; it is enough that the prior stockholders be the "most feasible source of the new capital." *See* 308 U.S. at 121 n. 15, 60 S.Ct. at 10 n. 15 (internal quotation omitted).

words, if an exclusive participation plan satisfies that requirement, then it allows the partners the sole right to participate in a new value transaction not because of illegitimate collusion between old equity and the plan proponent but because such participation is necessary for a successful reorganization and in the best interests of all concerned. Of course, any exclusive participation plan must also fulfill the new value doctrine's four other requirements as well.

In sum, where the strictures of the new value exception are met, there is simply no violation of the absolute priority rule, whether the plan provides for exclusive or non-exclusive participation, because old equity will not retain or receive property "on account of" its old ownership interests

in violation of section 1129(b)(2)(B)(ii).

B. Congress' Failure to List the New Value Exception as a Specific Doctrine Permitted under the "Fair and Equitable" Principle Does Not Demonstrate an Intent to Eliminate It.

While the absolute priority rule clearly does not prohibit confirmation of a new value exception plan in a cramdown, this does not necessarily mean that the "fair and equitable" provisions of the Code should be interpreted as permitting confirmation of such a plan. Bancorp argues that Congress' failure expressly to provide for the continuation of the new value exception in the provision setting forth the requirements of the "fair and equitable" principle must be interpreted as an implicit statement that it did not intend the doctrine to survive the adoption of the Code. Recognizing that the Code does not unambiguously

allow for new capital contribution plans, Bonner argues that such plans are consistent with the "fair and equitable" principle and that despite the absence of an express provision, Congress intended to maintain the new value exception.

Bonner relies upon "the normal rule of statutory construction . . . that if Congress intends for legislation to change the interpretation of a judicially created concept, it makes that intent specific." *Midlantic Nat'l. Bank v. New Jersey Dept. of Envtl. Protection*, 474 U.S. 494, 501, 106 S.Ct. 755, 759, 88 L.Ed.2d 859 (1986) (citations omitted); *Kelly v. Robinson*, 479 U.S. 36, 47, 107 S.Ct. 353, 359, 93 L.Ed.2d 216 (1988). This rule is followed with particular care in construing the Bankruptcy Code. *Midlantic*, 474 U.S. at 501, 106 S.Ct. at 759. When Congress amends the bankruptcy laws, it does not start from scratch.

See *Dewsnup v. Timm*, --- U.S. ----, ----, 112 S.Ct. 773, 779 (1992). The Bankruptcy Code should not be read to abandon past bankruptcy practice absent a clear indication that Congress intended to do so. *Pennsylvania Public Welfare Dept. v. Davenport*, 495 U.S. 552, 563, 110 S.Ct. 2126, 2133, 109 L.Ed.2d 588 (1990).[31]

At oral argument Bancorp suggested that the new value exception was mentioned once in dicta by the Supreme Court in *Case v. Los Angeles Lumber Products* and thereafter never heard from again. Consequently, Bancorp argues that

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[31] Bancorp argues that the *Midlantic/Kelly* rule of construction set forth above applies only where there is a conflict between bankruptcy law and non-bankruptcy law. While there is language in *United States v. Ron Pair Enterp., Inc.*, 489 U.S. 235, 245, 109 S.Ct. 1026, 1033, 103 L.Ed.2d 290 (1988), supporting such a narrow view of those cases, the later *Davenport* case gives a broader reading to the *Midlantic/Kelly* principle. *Davenport* applied the principle where there was no conflict with non-bankruptcy law. *Dewsnup*, an even later case, is consistent with *Davenport's* approach.

Congress would not have known of the principle when it enacted the Code. *Cf. United States v. Ron Pair Enterp., Inc.*, 489 U.S. 235, 246, 109 S.Ct. 1026, 1033, 103 L.Ed.2d 290 (1988) (practice of denying post-petition interest to holders of non-consensual liens was an exception to an exception practiced only by a few courts so Congress would not have known of it). We disagree.

There is simply no question that the new value exception was an established pre-Code Bankruptcy practice of which Congress would have had (and did have) knowledge. *Snyder v. Farm Credit Bank of St. Louis (In re Snyder)*, 967 F.2d 1126, 1129 (7th Cir.1992). First, several Supreme Court cases had mentioned the principle, albeit the last time in 1946. Second, several appellate court cases recognized the new value doctrine after 1946: *E.g., Phelan v. Middle States Oil*

Corp., 220 F.2d 593, 614 (2d Cir.), *cert. denied*, 349 U.S. 929, 75 S.Ct. 772, 99 L.Ed. 1260 (1955); *Security & Exch. Comm'n v. Canandaigua Enterp. Corp.*, 339 F.2d 14, 21 (2d Cir.1964). Finally, a proposal to broaden the new value exception was put before Congress during the drafting of the Code. While the proposal was rejected, that action demonstrates that Congress knew of the doctrine when it enacted the Code.

Once it has been shown that Congress was aware of a pre-Code practice, the remaining inquiry under *Dewsnup* and *Davenport* is whether it has made clear its intent to change that practice. Bancorp argues that the codification of the formerly judicially-defined concept of "fair and equitable" without a reference to the new value exception shows Congress' clear intent to eliminate

the doctrine.[32] *See In re A.V.B.I., Inc.*, 143 B.R. 738, 743 (C.D.Cal.1992). However, section 1129(b)(2) explicitly defines the term "fair and equitable" as merely including the general requirements listed in the Code and expressly leaves room for additional factors to be considered in applying the principle in other particular circumstances. *See* 11 U.S.C. § 102(3) (defining "includes" as "not limiting"). There is nothing in the language of the Code that suggests that courts cannot continue to apply the requirements of the new value exception in determining whether a plan that affords old equity a property interest in exchange for a capital contribution is

[32] The term "fair and equitable" originated in the field of equity receivership reorganizations. *Case v. Los Angeles Lumber*, 308 U.S. at 115, 60 S.Ct. at 6. The phrase was first codified in 1934 as section 77B(f)(1) of the Bankruptcy Act but given no statutory definition. Section 77B was repealed and replaced by Chapter X of the Bankruptcy Act in 1938.

"fair and equitable". *See Official Creditors' Comm. ex rel. Class 8 Unsecured Creditors v. Potter Material Serv., Inc. (In re Potter Material Serv., Inc.)*, 781 F.2d 99, 101-02 (7th Cir.1986). In any event, the text of section 1129(b)(2) does not evidence the clear intent necessary to support a conclusion that Congress decided to eliminate the new value doctrine; silence is not a sufficient basis from which we may infer such a purpose. *See Kelly*, 479 U.S. at 47, 107 S.Ct. at 359.

Where the text of the Code does not unambiguously abrogate pre-Code practice, courts should presume that Congress intended it to continue unless the legislative history dictates a contrary result. *See Dewsnup*, --- U.S. at ----, 112 S.Ct. at 779. It does not do so here. If anything, the legislative history of the Code supports the

continued existence of the new value doctrine. It contains statements by sponsors of the Code that although section 1129(b)(2) lists several specific factors interpreting "fair and equitable", others were omitted to avoid statutory complexity and because courts would independently find that they were fundamental to "fair and equitable treatment".[33] *See* 124 Cong.Rec. 32407 (Sept. 28, 1978) (Statement of Rep. Don Edwards); 124 Cong.Rec. 34006 (Oct. 5, 1978) (statement of Senator Dennis DeConcini). This legislative history is evidence that Congress enacted the Code with knowledge that other, judicially-created standards governing the

[33] One example of a well-established component of "fair and equitable" that was not included was the concept that no senior class is to receive more than 100 percent of the amount of its claims. For a discussion of the uncodified aspects of the "fair and equitable" principle under the Bankruptcy Code, *see* Kenneth N. Klee, *Cram Down II* 64 Am.Bankr.L.J. 229 (1990).

application of the "fair and equitable" principle existed and that it failed to include such standards for reasons other than an intent to eliminate them.

As stated earlier, in enacting the Code Congress rejected a proposal by the Bankruptcy Commission to expand the new value exception significantly. *See* Victor Brudney, *The Bankruptcy Commission's Proposed Modifications of the Absolute Priority Rule*, 48 Am.Bankr.L.J. 305, 335-36 (1974). That proposal would have eliminated the "money or money's worth" requirement set forth in *Case v. Los Angeles Lumber* and permitted new "important" contributions, including contributions of management, to suffice. *Report of the Commission on the Bankruptcy Laws of the United States*, H.R.Doc. No. 93- 137, 93d Cong., 1st Sess., pt. I, 258-59; pt. II, §§ 7-303(7), 7-310 (1973); *Norwest Bank*

Worthington v. Ahlers, 485 U.S. 197, 205-06, 108 S.Ct. 963, 968-69, 99 L.Ed.2d 169 (1988). Congress' rejection of the Bankruptcy Commission's proposal shows only that it did not want to broaden the exception; it does not indicate rejection of the exception itself. *Travelers Ins. Co. v. Bryson Properties, XVIII, (In re Bryson Properties, Inc., XVIII)*, 961 F.2d 496, 504 n. 13 (4th Cir.), *cert. denied*, --- U.S. ----, 113 S.Ct. 191, 121 L.Ed.2d 134 (1992). Indeed, "the Commission's proposal presupposed the existence of the new value exception, and Congress's rejection of the modification could just as easily be construed as an endorsement of the status quo." *Snyder*, 967 F.2d at 1130.

In sum, neither the text nor the legislative history of section 1129(b)(2) justifies the conclusion that the new

value exception was eliminated. *See Bryson*, 961 F.2d at 504 n. 13. Congress' failure to include explicitly the well-established requirements of the new value exception in section 1129(b)(2) is of no assistance to Bancorp. Given that there is no evidence of a clear intent on the part of Congress to eliminate the new value exception in either the statutory text or the legislative history, under *Dewsnup* and *Davenport* pre-Code practice continues to apply.

C. Congress' Overhaul of the Reorganization Process Does Not Justify a Conclusion that the New Value Exception was Abolished.

Bancorp contends that where the Code totally revamps an area of bankruptcy law, pre-Code practice may appropriately be ignored. Bancorp relies on *Union Bank v. Wolas*, --- U.S. ----, 112 S.Ct. 528, 116 L.Ed.2d 514 (1992), in support of this proposition. In *Wolas* the Court

unanimously found that the text of the Code sharply limited the pre-Code practice at issue. Under the Bankruptcy Act a trustee could avoid a debtor's payments on a long-term debt if they were made during the ninety days prior to bankruptcy. However, he could not avoid such payments made on current expenses. In contrast, section 547(c)(2) of the Code states that a trustee cannot avoid payments made during the prescribed period if they were in the "ordinary course of [the debtor's] business or financial affairs". The Court found that the plain meaning of this Code section circumscribed the trustee's pre-Code avoidance powers with respect to long term debt. --- U.S. ----, 112 S.Ct. at 530. While the *Wolas* Court relied in part upon the major changes made to the statutory framework by the enactment of the Code, it did so only as a

confirmation of its earlier conclusion that the plain text of the Code provision altered pre-Code practice. --- U.S. at ----, ----, 112 S.Ct. at 530, 532. Here, and as shown above, the language of the text at issue, section 1129(b)(2), does not by its terms affect the new value exception in any respect.

Bancorp next argues that the changes made to the reorganization process were more drastic than those at issue in *Wolas* and therefore pre-Code practice should be discarded. As Bancorp notes, under the Bankruptcy Act there were two reorganization chapters, X (publicly held companies) and XI (privately held companies), which varied in certain important respects.[34] On the one hand, Congress' combining them into a single

[34] For example, Chapter X had an absolute priority rule; Chapter XI did not. Trustees were mandatory in Chapter X cases; the debtor retained control under Chapter XI.

reorganization chapter was a significant Code innovation. *See A.V.B.I.*, 143 B.R. at 747. On the other hand, the new Chapter 11 shifted bargaining power away from creditors and in favor of debtors. Consequently, it made plan confirmation easier. While it might be, as Bancorp argues, that the new value exception is not as necessary under the current regime, *see also In re Outlook/Century Ltd.*, 127 B.R. 650, 657 (Bankr.N.D.Cal.1991), we believe that the structural changes to the reorganization process made by the Code are in harmony with the pro-confirmation principle underlying the new value exception. Accordingly, these changes cannot carry Bancorp's argument that the new value doctrine is no longer viable.

Specifically, Bancorp recounts that under the Act voting on the confirmation of a plan was by individual creditors

rather than by classes of creditors, as is the case under the Code.[35] It contends that the new value exception was designed merely to prevent one dissenting creditor from preventing confirmation. *See Lumber Exchange Ltd. Partnership* v. *The Mut. Life Ins. Co. of N.Y. (In re Lumber Exchange Ltd. Partnership)*, 125 B.R. 1000, 1007 & n. 10 (Bankr.D.Minn.), *aff'd* 134 B.R. 354 (D.Minn.1991), *aff'd* 968 F.2d 647 (8th Cir.1992). However, there is no significant difference between the problem that a holdout class poses for confirmation and that posed by a holdout creditor. *Woodscape Ltd. Partnership (In re Woodscape Ltd. Partnership)*, 134 B.R. 165, 168, 171 (Bankr.D.Md.1991). While Bancorp assumes that the new value exception was intended

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[35] Creditors are given guarantees as *individual creditors* under the best interests test. 11 U.S.C. § 1129(a)(7).

to solve a no longer existent individual holdout problem, it could just as logically be argued that the new value exception was designed to prevent confirmation holdouts, individual or class, from derailing an otherwise "fair and equitable" plan. *See In re Pullman Construction Indus.*, 107 B.R. 909, 944-45 (Bankr.N.D.Ill.1990). From this perspective, the rationale for the new value exception is as applicable today as it ever was, and there is no reason for us to view it as defunct.

Bancorp also contends that the Code meant to give creditors, not the bankruptcy court, the power to decide when to waive the absolute priority rule. *See Kham & Nate's Shoes No. 2 v. First Bank*, 908 F.2d 1351, 1360 (7th Cir.1990) (creditors effectively own bankrupt firms and they should decide whether old equity should participate). It is true that 11

U.S.C. section 1126(c) allows creditors to consent to confirmation of a plan that does not comply with the absolute priority rule. However, that section permits creditors to waive a priority they possess. The new value exception allows bankruptcy courts to afford a priority to others over the creditors. There is simply no logical analysis that would allow us to conclude that by permitting creditors to waive their own priority Congress demonstrated the intent to deprive bankruptcy courts of their power to afford investors of new capital a priority over an impaired class of creditors. Moreover, the very purpose of the Code's cramdown provision, section 1129(b), which had no direct equivalent under the Act, is to allow the court, and not the creditors, to decide whether a "fair and equitable" plan should be confirmed over creditor objections.

While creditor autonomy is certainly an important aspect of the reorganization process, the argument that the new value exception impedes that autonomy is really a complaint against the practice of confirmation by cramdown. That grievance cannot be addressed here.

Finally, Bancorp argues that the Code's creation of the entity of the debtor-in-possession to run the business in lieu of a trustee would cause self-dealing by insiders if the new value exception were still allowed. *See A.V.B.I.*, 143 B.R. at 743. However, the very purpose of the Code's creation of the debtor-in-possession was to increase the power of those in control of the debtor during the reorganization process. Bankruptcy law is very formalistic in that it treats the debtor, the debtor-in-possession, and old equity as legally distinct entities when in reality they

may all be one and the same. *See, e.g., In re Kendavis Industries Int'l, Inc.*, 91 B.R. 742, 751, 754 (N.D.Tex.1988) (law firm has conflict of interest in representing both the debtor and equity in bankruptcy proceeding); *In re Rusty Jones, Inc.*, 134 B.R. 321, 343 (Bankr.N.D.Ill.1991) (same).

The risk of self-dealing among these entities at the expense of creditors is a risk created by the Code itself. The stringent requirements of the new value exception are designed to mitigate that risk. The enactment in the Code of changes that aggravate the self-dealing problem constitutes good reason for courts to make certain that a proposed new value plan strictly adheres to the requirements of the exception. The modifications to the reorganization process are not, however, cause for us to ignore several decades of bankruptcy

practice in determining Congress' intent with respect to the new value exception.

Despite all of the differences between the Act and the Code, the primary rationale for the new value exception has not been eliminated by any statutory alteration to the confirmation process. The new value exception is based on "practical necessit[y]", on the recognition that new money frequently could not be obtained for the reorganized debtor in the absence of that doctrine. *See Mason v. Paradise Irrigation Dist.*, 326 U.S. 536, 542, 66 S.Ct. 290, 292 (1946); *Kansas City Terminal Ry. Co. v. Central Union Trust Co.*, 271 U.S. 445, 455, 46 S.Ct. 549, 551 (1926). That practical necessity remains just as pertinent under the Code. Where the main justification for a long-term judicially sanctioned practice has not dissipated, either through a change in conditions or

by way of legislative amendment, there is simply no reason to disregard the practice absent a clear legislative intent to abolish it. Bancorp's structural-change arguments simply do not convince us that pre-Code practice should be ignored in this case.

D. The New Value Exception is Consistent with the Underlying Policies of Chapter 11.

In interpreting statutory language we are not confined to the specific provision at issue but may look to the structure of the law as a whole and to its object and policy. *Patterson v. Shumate*, --- U.S. ----, ---- - ----, 112 S.Ct. 2242, 2246-47, 119 L.Ed.2d 519 (1992); *Kelly v. Robinson*, 479 U.S. 36, 43, 107 S.Ct. 353 (1986). Chapter 11 has two major objectives 1) to permit successful rehabilitation of debtors (*NLRB v. Bildisco and Bildisco*, 465 U.S. 513, 527, 104 S.Ct. 1188, 1196, 79

L.Ed.2d 482 (1984)); and 2) to maximize the value of the estate *(Toibb v. Radloff*, --- U.S. ----, ----, 111 S.Ct. 2197, 2201, 115 L.Ed.2d 145 (1991)). The new value exception, properly applied, serves both goals. By permitting prior stockholders to contribute new money in exchange for participation in the reorganized company, the debtor is given an additional source of capital. The new contribution increases the amount available for the estate to use both in its reorganization and in funding the plan and paying creditors. Without the inducement of participation in the reorganized debtor, the new money may be unavailable. *Mason v. Paradise Irrigation*, 326 U.S. at 542, 66 S.Ct. at 292. All parties involved, including the creditors, benefit from an increase in the assets of the estate.

"'Prior owners are a source of capital different in kind from new investors in that they have an ongoing role in the reorganization and a prior investment in the company.'" *Prudential Ins. Co. v. F.A.B. Indus. (In re F.A.B. Indus.)*, 147 B.R. 763, 769 n. 13 (C.D.Cal.1992) (quoting Nimmer, *supra* note 23, at 1050), *appeal docketed*, No. 93-55055 (9th Cir. Jan. 13, 1993). Moreover, in many situations the new value exception allows control and management of the company to remain with the original owners, who arguably can best reestablish a profitable business. Old owners may have valuable expertise and experience that outside investors lack. *Snyder v. Farm Credit Bank of St. Louis (In re Snyder)*, 967 F.2d 1126, 1130 (7th Cir.1992). Some studies demonstrate that reorganizations have been more successful when former

management was allowed to use its expertise in running the business. Harvey Miller, *Commentary on Absolute Priority*, 1991 Annual Survey of American Law 49, 50.

It has been argued that the new value exception allows old equity to repurchase the business at a bargain price, while superior creditors go unpaid, and that this result is contrary to the Chapter 11 policy of protecting creditor interests. *See, e.g., A.V.B.I.*, 143 B.R. at 747. We believe that this argument is incorrect in two respects. First, while the protection of creditors' interests is an important purpose under Chapter 11,[36] the Supreme Court has made clear that successful debtor reorganization and maximization of the

[36] For example, a Chapter 11 plan cannot be confirmed unless the court finds that creditors will receive under it at least as much as they would in a liquidation. § 1129(a)(7).

value of the estate are the primary purposes.[37] *See Bildisco*, 465 U.S. at 527, 104 S.Ct. at 1196; *Toibb v. Radloff*, --- U.S. ----, 111 S.Ct. at 2201. Chapter 11 is designed to avoid liquidations under Chapter 7, since liquidations may have a negative impact on jobs, suppliers of the business, and the economy as a whole. *See United States v. Whiting Pools, Inc.*, 462 U.S. 198, 203, 103 S.Ct. 2309, 2312, 76 L.Ed.2d 515 (1983). The ability of stockholders to remain in possession and control of operations, rehabilitate the business, and retain ownership through the new value exception encourages debtors to attempt Chapter 11 reorganization instead of simply

[37] From one perspective, the debate over the survival of the new value exception is a division between those who perceive the paramount objective of Chapter 11 to be successful reorganization of the debtor and those who believe it should be protection of creditors' interests.

liquidating their assets and starting over.

Second, we believe that if the new value exception's requirements are properly applied, creditors' interests will generally be benefited as well. The strictures of the new value doctrine provide creditors with significant safeguards against collusion between the proponent of the reorganization plan and the old equity owners.[38] Although the new value exception has been criticized as a subversion of the absolute priority rule, its requirements actually enhance the rule. As we noted earlier, they constitute guidelines by which a court can ensure that old equity will not acquire an interest in the reorganized debtor or other property on account of

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[38] If old equity contributes a substantial amount of new capital to the business undergoing reorganization, then the risk of a later failure falls more heavily on stockholders than creditors. *See Nimmer, supra* note 23, at 1050-52, 1072-73.

its old ownership interests. In fact, the new value exception puts limits on the power of old equity to gain an interest in the reorganized business beyond that provided in the explicit language of the Code. For example, there is nothing in the text of the Code that prevents stockholders from obtaining property in the reorganized debtor in exchange for contributions of labor; such a transaction would not give old equity any property "on account of" its prior ownership interests. Yet the requirements of the new value exception prohibit this type of transaction. *See Norwest Bank Worthington v. Ahlers*, 485 U.S. 197, 204-06, 108 S.Ct. 963, 967-69, 99 L.Ed.2d 169 (1988) (contributions must be money or money's worth).[39]

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[39] *See also In re Stegall*, 865 F.2d 140, 142-44 (7th Cir.1990) (the contribution of one hundred pigs among other farm related items of unknown value does not satisfy the new value exception).

As long as courts carefully apply the new value exception, it will not operate as a mechanism by which old equity can escape the requirements of the absolute priority rule. If a plan meets all the requirements of the new exception, it may be confirmed in a cramdown, assuming all other conditions for confirmation are present. Within the confines of the Code, bankruptcy courts are courts of equity. *Ahlers,* 485 U.S. at 206, 108 S.Ct. at 968. Properly applied, the new value exception allows bankruptcy courts to fulfill their assigned role of balancing the interests of debtors, creditors, old owners, and the public, guided by the overriding goal of ensuring the success of the reorganization. *See Pioneer Inv. Serv. v. Brunswick Assoc.,* --- U.S. ----, 113 S.Ct. 1489, 1495, 123 L.Ed.2d 74 (1993).

Thus, our conclusion that nothing in the Bankruptcy Code forbids the confirmation of plans that comply with the new value doctrine is entirely consistent with Congressional bankruptcy policy. Because our reading of the statute will not produce results demonstrably at odds with the intentions of its drafters, we must enforce the Code according to its terms. *United States v. Ron Pair Enterp., Inc.,* 489 U.S. 235, 242, 109 S.Ct. 1026, 1030, 103 L.Ed.2d 290 (1988). Therefore, Bonner's Plan is not unconfirmable simply because it provides for a new value transaction.

V. THE NEW VALUE EXCEPTION AND THE BANCORP'S MOTION FOR RELIEF FROM THE AUTOMATIC STAY

As noted above, the precise issue posed by Bancorp's motion for relief from stay is not whether Bonner's plan will ultimately be confirmed under section 1129 but whether there is a reasonable

possibility that it can be confirmed within a reasonable time. That is all that Bonner need show to defeat Bancorp's section 362(d)(2) motion. *United Sav. Ass'n of Tex. v. Timbers of Inwood Forest Assoc., Ltd.*, 484 U.S. 365, 376, 108 S.Ct. 626, 633, 98 L.Ed.2d 740 (1988). It need not put forth evidence of the type it would be required to produce in a confirmation hearing. *See John Hancock Mutual Life Ins. Co. v. Route 37 Business Park Assoc.*, 987 F.2d 154, 162 (3d Cir.1993).

Bancorp correctly argues that if Bonner's Plan cannot possibly satisfy all of the requirements of the new value exception it cannot be confirmed as a matter of law and relief from the stay must be granted. While it is true that in certain cases an appellate court can determine the feasibility of confirmation as a matter of law, *see id.*, because of

the lack of a sufficient factual record we cannot do so here. The bankruptcy court never held a hearing on the feasibility of the confirmation of Bonner's plan and the district court failed to reach the issue as well. On this record we cannot say as a matter of law that Bonner's proposed Plan cannot satisfy all of the requirements of the new value exception.[40] A remand to the bankruptcy court is required to determine the feasibility of confirmation and whether, despite the survival of the new value exception, Bancorp's motion fo_

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[40] Courts and commentators have noted certain conceptual difficulties regarding valuation inherent in the application of the new value exception. *E.g.*, *In re Bjolmes Realty Trust*, 134 B.R. 1000, 1008-10 (Bankr.D.Mass.1991); Markell, *supra* note 23, at 119-21. While we are aware that valuation can be complicated and uncertain in this context, as well as in bankruptcy generally, *see, e.g.*, *Official Creditors' Comm. ex rel. Class 8 Unsecured Creditors v. Potter Material Serv., Inc. (In re Potter Material Serv., Inc.)*, 781 F.2d. 99, 104 (7th Cir.1986); *Nimmer*, *supra* note 23 at 1044, we shall not address valuation methodology at this juncture. We believe the better course is to explore this issue at a later date, in the context of a concrete factual situation.

relief from the stay of the foreclosure sale of Bonner Mall should be granted.

VI. CONCLUSION

Viewed properly, "the new value exception" may be seen as a rule of construction, or a rule that serves to define the meaning of the absolute priority rule and determine when it has been satisfied. As such it is as pertinent today as it was under pre-Code bankruptcy practice. The arguments that Bancorp advances do not persuade us that Congress would have had any reason to disregard a beneficial rule of construction that assists courts in implementing an important bankruptcy doctrine at the very time it was incorporating that doctrine into the Bankruptcy Code.

Nothing in the text of the Code prohibits the confirmation of plans that properly employ the new value doctrine.

Nor does the legislative history demonstrate that Congress intended to abrogate this judicially created, pre-Code legal principle. Therefore, we conclude that the new value "exception", with its stringent requirements, survives. We recognize that, if applied carelessly, the doctrine has the potential to subvert the interests of creditors and allow debtors and old equity to abuse the reorganization process. The proper answer to these concerns is vigilance on the part of bankruptcy courts in ensuring that all of the requirements of the new value exception are met in every case. Here, it is unclear whether Bonner's plan can meet all of the requirements of the doctrine and achieve confirmation. Nevertheless, it may well be within the realm of potentially confirmable plans and thereby survive Bancorp's motion for

relief from the automatic stay. The bankruptcy court must make that determination initially.

The judgment of the district court is AFFIRMED and the case is REMANDED to the bankruptcy court for further proceedings consistent with this opinion.

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IN THE UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF IDAHO

In the Matter of BONNER MALL PARTNERSHIP, Debtor.	Case No. 92-0023-N-HLR Consolidated with Case No. 20046-N-HLR
BONNER MALL PARTNERSHIP, Appellant/Plaintiff, v. U.S. BANCORP MORTGAGE COMPANY, Appellee/Defendant.	NOTICE OF APPEAL

Notice is hereby given that U.S. Bancorp Mortgage Company, appellee/defendant above named, hereby appeals to the United States Court of Appeals for the Ninth Circuit, from the final Opinion and Order entered in this action on the 15th day of July, 1992, as corrected by the Correction Order dated July 23, 1992.

DATED this 14th day of August, 1992.

STOEL RIVES BOLEY JONES & GREY

By ______/s/______

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CERTIFICATE OF SERVICE

I HEREBY CERTIFY that on the 14th day of August, 1992, a trust and correct copy of the foregoing NOTICE OF APPEAL was served upon the following by United States Mail, postage prepaid:

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/s/______

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IN THE UNITED STATES DISTRICT COURT

FOR THE DISTRICT OF IDAHO

In re: BONNER MALL PARTNERSHIP, Debtor.	CASE NO. NO. 92-0023-N-HLR consolidated with Case No. 92-0046-N-HLR
BONNER MALL PARTNERSHIP, Appellant/Plaintiff, v. U.S. BANCORP MORTGAGE COMPANY, Appellee/Defendant.	CORRECTION ORDER

It having come to the court's attention that a typographical error appears in its Opinion and Order filed July 15, 1992, wherein the Bankruptcy Court's Order of December 6, 1991, is listed as being dated December 6, *1992*, IT IS HEREBY ORDERED that section "***III. ORDER***" at page 15 be corrected to read as follows:

> Based upon the foregoing, and the court being fully advised in the premises,
>
> IT IS HEREBY ORDERED that the Order of the bankruptcy court filed December 6, 1991, should be, and is hereby, REVERSED, and the case is REMANDED to the bankruptcy court for proceedings consistent with this opinion.

DATED this 23rd day of July, 1992.

/S/
HAROLD L. RYAN
UNITED STATES DISTRICT COURT

IN THE UNITED STATES DISTRICT COURT

FOR THE DISTRICT OF IDAHO

In re:	
BONNER MALL PARTNERSHIP, 92-	CASE NO. 0023-N-HLR
consolidated	
Debtor. 92-	with Case No. 0046-N-HLR)
BONNER MALL PARTNERSHIP,	
Appellant/Plaintiff,	
v.	
U.S. BANCORP MORTGAGE COMPANY,	OPINION AND ORDER
Appellee/Defendant.	

I. FACTS AND PROCEDURE

This matter is currently before this court on appeal from an Order entered by the United States Bankruptcy Court for the District of Idaho on December 6,

1991. Having reviewed the entire record herein, the court determined that the decisional process would be significantly aided by oral argument. Accordingly, a hearing was held July 10, 1992.

The Debtor in this case is the Bonner Mall Partnership, an Idaho general partnership comprised of six partners. The Debtor was formed in 1986 for the purpose of acquiring the Bonner Mall (hereinafter "Mall"), a retail shopping center located on 16 acres of land one mile north of Sandpoint, Idaho, in Bonner County. Northtown Investments constructed the Mall in 1984-85 using a $6.2 million loan from First National Bank of North Idaho. U.S. Bancorp Mortgage Company (hereinafter "U.S. Bancorp") acquired the loan from First National Bank of North Idaho in 1986. The Debtor purchased the Mall from Northtown Investments on October 31,

1986. The Debtor hoped to be able to service the debt with the rental income from the Mall tenants; however, this does not prove to be the case. In July 1990, a Notice of Default and a Notice of Trustee's Sale was filed against the Debtor on account of delinquent real property taxes. Subsequent negotiations between Bonner County, U.S. Bancorp and the Debtor to solve the tax problem and to restructure the debt, broke down. Thereafter, on March 13, 1991, the Debtor filed for relief under Chapter 11 of the United States Bankruptcy Code.

U.S. Bancorp filed a motion to dismiss the Chapter 11 proceeding, and also a motion to modify stay, seeking relief from the automatic stay under 11 U.S.C. § 362(a) to enable it to foreclose its security interest in the Bonner Mall. Both motions came on for hearing before the bankruptcy court. On August 23,

1991, the bankruptcy court issued its first Memorandum of Decision. That decision valued U.S. Bancorp's collateral, the Mall, at $3.2 million and initially denied U.S. Bancorp's motions subject to the Debtor filing a plan of reorganization within 30 days. In this first decision, the bankruptcy court did not express any opinion as to the viability of the "new value exception" which is the basis of the present appeal.

On October 31, 1991, the Debtor filed its First Amended Plan of Reorganization. Under the plan, the Debtor is proposing to transfer all of the assets of the Mall to a new entity, Bonner Property, Inc. (hereinafter "Bonner Properties"). The existing partners of the Debtor would contribute to Bonner Properties $200,000.00, plus amounts needed to complete court-ordered repairs. A non-debtor party would also

grant to Bonner Properties a collateral trust mortgage on 4500 acres of real property, the value of which seems to be disputed. In exchange for the capital contribution and the real property, the existing partners would receive two million shares of common stock in the corporation.

With respect to the Debtor's liabilities, the Plan provides for the secured portion of U.S. Bancorp's claim, equal to the $3.2 million value of the Mall, to be repaid in a single "balloon" payment after 32 months, with U.S. Bancorp to receive monthly interest payments in the interim. The other secured creditors will also be paid the value of their collateral on a deferred basis. In regard to the unsecured creditors' class, of which U.S. Bancorp is also a member, the plan proposes a pro rata distribution of 300,000 shares of

Class A preferred stock in Bonner Properties. The shares would have a par value of $1.00 and would be convertible at any time after the payment of U.S. Bancorp's secured claim into a maximum 15 percent of the then outstanding shares of common stock. The preferred stock is given a liquidation preference equal to its par value – $300,000.00.

In response to the First Amended Plan of Reorganization, U.S. Bancorp renewed its motions for relief from stay and dismissal of the case, arguing that the Bankruptcy Code, enacted in 1978, did not retain the new value exception to the absolute priority rule, and therefore, the plan was not confirmable as a matter of law. After a hearing on the matter, the bankruptcy court issued a second Memorandum of Decision and a separate Order on December 6, 1991. The order granted U.S. Bancorp's motion for relief

from stay, and denied U.S. Bancorp's motion to dismiss. The Memorandum of Decision in support of the Order provides in relevant part:

> Since the time of the previous decision on this subject in this case, the Fifth Circuit Court of Appeals in *Phoenix Mutual Life Ins. Co. v. Greystone III Joint Venture* has held the new value exception is not available under the Bankruptcy Code. The opinion holds the 1978 Bankruptcy Code did not provide for [the] new value exception to the absolute priority rule. The Court discussed the effect of allowing the exception under the present Code and found that to do so would allow "old equity" to retain control of, and run, the reorganized debtor while impairing the rights of dissenting secured creditors and that such treatment is not authorized and should not be authorized under the present statutes.
>
> The *Greystone* analysis is convincing, as is the reasoning . . . in *In re Outlook/ Century, Ltd.*, As in *Greystone*, to allow the debtor equity holders in this case to retain controlling interest in the new entity while reducing the amount of the [U.S.]

> Bancorp secured claim and not paying the unsecured claim in full would violate the absolute priority rule.

Memorandum of Decision, filed Dec. 6, 1991, at 4-5 (footnotes omitted).

On December 11, 1991, Debtor filed its Notice of Appeal from the December 6, 1991, Memorandum of Decision and separate Order. On December 11, 1991, the bankruptcy court signed a formal order submitted by U.S. Bancorp. The Debtor filed a second notice of appeal on December 23, 1991, in response to the signing of the formal order. On February 11, 1992, this court issued an order consolidating the appeals.

Having thoroughly considered the briefs submitted herein, along with the entire record on appeal, and the arguments by counsel at the hearing held on July 10, 1992, the court finds that

the decision of the Bankruptcy Court should be reversed.

II. ANALYSIS

A. Issue on Appeal.

The sole issue before the court on appeal is whether the enactment of the 1978 Bankruptcy Code revoked the new value exception to the absolute priority rule recognized under the bankruptcy Act.

B. Standard of Review.

The bankruptcy court's findings of fact may not be disturbed on appeal unless clearly erroneous. Bankruptcy Rule 8013. However, the bankruptcy court's conclusions of law are reviewed *de novo*. *Ragsdale v. Haller*, 780 F.2d 794, 795 (9th Cir.1986).

C. History of the Absolute Priority Rule and the New Value Exception.

In order for a Chapter 11 plan of reorganization to be confirmed, it must

meet the requirements set forth in 11 U.S.C. § 1129. Section 1129(a) sets out these requirements, one of which is that each class of claims must accept the plan. However, there is an exception to this requirement in Section 1129(b). Section 1129(b)(1) provides that if all other requirements for confirmation under Section 1129(a) have been met, the court may confirm a reorganization plan over the objection of an impaired class or classes "if the plan does not discriminate unfairly, and is *fair and equitable*, with respect to each class of claims or interests that is impaired under, and has not accepted, the plan." 11 U.S.C.S. § 1129(b)(1) (1987) (emphasis added).

This fair and equitable standard was created by the courts around the turn of the century. The Supreme Court in *Louisville Trust Co. v. Louisville, N.*

Albany & Chicago Ry., 174 U.S. 674 (1899), fashioned what has become known as the absolute priority rule. The Supreme Court stated:

> [T]he stockholder's interest in the property is subordinate to the rights of creditors; first of secured and then of unsecured creditors. And any arrangement of the parties by which the subordinate rights and interests of the stockholders are attempted to be secured at the expense of the prior rights of either class of creditors comes within judicial denunciation.

Id. at 684. In essence, "[t]he absolute priority rule requires that a dissenting class of creditors be provided for fully before any junior class may receive or retain any interest in the reorganized firm." *In re SLC LIMITED V*, 22 Bankr. Ct. Dec. (CRR) 1081, 1082 (Bankr. D. Utah (1992)).

The courts created an exception to this rule, known as the "new value exception." In *Kansas City Terminal Ry.*

Co. v. Central Union Trust Co., 271 U.S. 445 (1926), the Supreme Court explained:

> As above stated, to the extent of their debts creditors are entitled to priority over stockholders against all the property of an insolvent corporation. But it does not follow that in every reorganization the securities offered to general creditors must be superior in rank or grade to any which stockholders may obtain. It is not impossible to accord to the creditor his superior rights in other ways. Generally, additional funds will be essential to the success of the undertaking, and it may be impossible to obtain them unless stockholders are permitted to contribute and retain an interest sufficiently valuable to move them. In such or similar cases the chancellor may exercise an informed discretion concerning the practical adjustment of the several rights.

Id. at 455.

The fair and equitable language was incorporated into the former Bankruptcy Act in Section 77B. The Supreme Court in *Case v. Los Angeles Lumber Products Co.*,

308 U.S. 106 (1939), was called upon to decide whether the absolute priority rule and the new value exception had been codified in the Act. The Supreme Court concluded that both had been codified.

> It is, of course, clear that there are circumstances under which stockholders may participate in a plan of reorganization of an insolvent debtor. This Court, as we have seen, indicated as much in *Northern Pacific Ry. Co. v. Boyd, supra*, and *Kansas City Terminal Ry. Co. v. Central Union Trust Co., supra*. Especially in the latter case did this Court stress the necessity, at times, of seeking new money "essential to the success of the undertaking" from the old stockholders. Where that necessity exists and the old stockholders make a fresh contribution and receive in return a participation reasonably equivalent to their contribution, no objection can be made.

Id. at 121 (citations omitted) (footnote omitted).

Presently, courts have placed strict conditions on the application of the new value exception.

> In order for the new value exception to apply, the contribution made by the equity holder must be: 1) in "money or money's worth"; 2) "reasonably equivalent" in value to the continued participation of the stockholders; 3) "necessary" to the reorganization; 4) a "fresh" contribution to the reorganization.

In re Sovereign Group, No. 89-10721F, 1992 U.S. Dist. LEXIS 9177 at *16 (E.D. Pa. June 30, 1992) (citation omitted).

Section 77B was replaced by Section 1129(b) of the Bankruptcy Code enacted in 1978. As stated above, the fair and equitable language has been adopted in this section. The section further provides in part:

> (2) For the purpose of this subsection, the condition that a plan be fair and equitable with respect to a class includes the following requirements:

. . . .

(B) With respect to a class of unsecured claims —

(i) the plan provides that each holder of a claim of such class receive or retain on account of such claim property of a value, as of the effective date of the plan, equal to the allowed amount of such claim; or

(ii) the holder of any claim or interest that is junior to the claims of such class will not receive or retain under the plan on account of such junior claim or interest any property.

11 U.S.C.S. § 1129(b)(2) (1987).

D. In Regard to the Existence of the New Value Exception.

Appellant argues that the new value exception survived the enactment of the 1978 Bankruptcy Code and is still applicable under Section 1129(b). In the bankruptcy court's second Memorandum of Decision, cited above, the Court found the Fifth Circuit's decision in *Greystone* "convincing." Subsequent to the

bankruptcy court's decision, the Fifth Circuit, upon rehearing of the earlier *Greystone* decision, withdrew the portion of the earlier decision addressing the new value exception to the absolute priority rule. The Fifth Circuit stated: "[T]he bankruptcy court's opinion on the 'new value exception' to the absolute priority rule has been vacated and we express no view whatever on that part of the bankruptcy court's decision." *Phoenix Mut. Life Ins. Co. v. Greystone III Joint Venture*, 948 F.2d 134, 142 (5th Cir.1991) (as amended on Petition for Rehearing, per curiam, Feb. 27, 1992). Appellant contends that the withdrawal of the earlier *Greystone* opinion undermines the bankruptcy court's decision, since the bankruptcy court relied so heavily on that opinion. In addition, appellant also cites other circuit and district courts which have stated their belief

that the new value exception survived the enactment of the 1978 Bankruptcy Code.

Appellant asserts that under the application rules of statutory construction, the new value exception was not eliminated. Specifically, appellant cites *Dewsnup v. Timm*, 502 U.S. ___, 116 L. Ed. 2d 903 (1992). Appellant argues that this case requires the court to construe Section 1129(b) consistent with pre-Code practices, including recognizing the existence of the new value exception.

In addition, appellant argues that the language of the statute is not inconsistent with the new value exception. Specifically, the appellant argues that the use of the word "includes" in Section 1129(b)(2) shows that the statute does not purport to be all inclusive. Section 102(3) states, "'includes' and 'including' are not limiting. . . ." 11 U.S.C. § 102(3)

(1985). Therefore, the appellant argues that the statute is not inconsistent with the new value exception.

In response, appellee argues that the Fifth Circuit's withdrawal of its earlier opinion does not undermine the bankruptcy court's decision in the instant case. The appellee points out that the bankruptcy court's decision also adopted the reasoning in *In re Outlook/Century Ltd.*, 127 B.R. 650 (Bankr. N.D. Cal. 1991), which held that the new value exception does not exist. In addition, appellee also cites cases from circuit and district courts that support its position that the new value exception no longer exists under the Code.

Appellee further argues that neither the statute nor the legislative history mention a new value exception. Appellee contends that Congress must have known of

the new value exception, and, therefore, its silence illustrates its intent to abolish that exception as it relates to Section 1129(b).

Appellee asserts that the language of the statute is unambiguous. Appellee also maintains that the former Bankruptcy Act stated the fair and equitable standard, but failed to furnish a definition. In contrast, appellee argues, the new Section 1129 *defines* "fair and equitable" by setting out the minimum requirements for a plan to be "fair and equitable." Appellee argues that *Dewsnup* is really inapplicable. In *Dewsnup*, the Supreme Court stated, "[o]f course, where the language is unambiguous, silence in the legislative history cannot be controlling." *Dewsnup v. Timm*, 116 L. Ed. 2d at 913. Therefore, appellee argues that the language of Section 1129 is unambiguous,

and urges the court to adopt the plain meaning of the statute and not construe the statute as consistent with pre-Code practices.

The court notes that the Ninth Circuit has yet to decide whether the new value exception has survived enactment of the Bankruptcy Code. In *Norwest Bank Worthington v. Ahlers*, 485 U.S. 197 (1988), the Supreme Court refused to resolve the issue of whether the new value exception survived.

> We need not reach this question to resolve the instant dispute. As we discuss infra . . . we think it clear that even if the Los Angeles Lumber exception to the absolute priority rule has survived enactment of the Bankruptcy Code, this exception does not encompass respondents' promise to contribute their "labor, experience, and expertise" to the reorganized enterprise.
>
> Thus, our decision today should not be taken as any comment on the continuing vitality of the Los Angeles

> Lumber exception – a question which has divided the lower courts since passage of the Code in 1978.

Id. at 203 n.3 (citations omitted).

This issue is essentially one of statutory construction. Since the bankruptcy court's decision, a new opinion has been issued which prescribes new standards for interpreting the Bankruptcy Code. In *Dewsnup*, the Supreme Court stated:

> When Congress amends the bankruptcy laws, it does not write "on a clean slate." . . . Furthermore, this Court has been reluctant to accept arguments that would interpret the Code, however vague the particular language under consideration might be, to effect a major change in pre-Code practice that is not the subject of at least some discussion in the legislative history. . . . Of course, where the language is unambiguous, silence in the legislative history cannot be controlling.

Dewsnup v. Timm, 116 L. Ed. 2d at 912-13 (citations omitted). The *Dewsnup* opinion

gives courts new guidelines when attempting to interpret the language of the Bankruptcy Code. The Supreme Court makes it clear that when the language of the code is somewhat ambiguous, courts should try to construe the language as consistent with pre-Code practices, unless some contrary intent is shown in the legislative history. The language at issue here is ambiguous to a certain extent. No mention is made in the language or the legislative history of the new value exception; yet, various courts have interpreted this language differently and are split on this issue, which illustrates that this language is not as clear as appellee argues. Furthermore, the use of the word "includes" demonstrates that the new value exception is not inconsistent with the language of Section 1129(b), since the requirements put forth are not all

inclusive. In addition, there is no evidence in the language of the statute or the legislative history which would indicate the desire of Congress to abandon the new value exception.

Two cases have addressed this issue since the *Dewsnup* opinion was handed down, and both have found that the new value exception survives. In *In re Sovereign Group, supra*, the court stated:

> On the other hand, the statutory language appears to be less clear in light of the fact that the new value exception is a judicially created exception which was in full use prior to the enactment of the Code in 1978. Where Congress intends for legislation to change the interpretation of judicially created concepts, it makes that intent specific; absent such specific intent, it is presumed that congress did not intend to change prior-existing law. *Midlantic National Bank v. New Jersey Department of Environmental Protection*, 474 U.S. 494, 501 (1986).
>
> Additionally, the Supreme Court recently reasserted the

> significance of bankruptcy practice prior to the passage of the Code and the Court's unwillingness to interpret the Code in a manner contrary to pre-Code practice. . . . *Dewsnup v. Timm*, 112 S.Ct. 773, 779 (1993) (citations omitted). This court is likewise hesitant to read the Code in contravention of pre-Code practice and will not hold that the new value exception has been extinguished.

Id. at *13-14.

In *In re SLC LIMITED V, supra*, the bankruptcy court also held that the new value exception survived the enactment of the 1978 Bankruptcy Code.

> Section 1129(b)(29) references some of the requirements of the "fair and equitable" standard, but on its face, it does not statutorily exclude nor eliminate the new value exception to the absolute priority rule. The use of the term "includes" also indicates that the requirements set forth in section 1129(b)(2)(B) are not limited to those indicated in that section.

Id. at 1083.

The court reiterated the *Dewsnup* analysis, and stated:

> Likewise, congressional silence regarding codification of the new value exception cannot be interpreted as eliminating a substantial, judicially created exception to the absolute priority rule especially when § 1129(b)(2) is not ambiguous on its face.
>
> . . . .
>
> Absent a showing of specific intent to change the judicially created new value exception, especially considering the plain language of the statute, it is not necessary in this case to "venture into the thicket of legislative history" to determine the scope of § 1129(b)(2). . . .
>
> . . . .
>
> Furthermore, the notion that the definition of "fair and equitable" is not longer a matter of common law and that section 1129(b)(2) "defines" it expressly is not supported by the legislative history.

Id. at 1084-85 (citations omitted).

The Fifth Circuit's withdrawal of the portion of the earlier *Greystone*

decision addressing the new contribution exception to the absolute priority rule further illustrates the trend after *Dewsnup* to interpret Section 1129(b) as consistent with pre-Code practices. Although the Fifth Circuit's decision to withdraw the earlier portion does not state whether it was influenced by the Supreme Court's decision in *Dewsnup*, the dissenting judge on rehearing seemed to imply that it did. "How one should approach issues of a statutory construction arising from the Bankruptcy Code has been clouded, in my view, by *Dewsnup v. Timm*. . . ." *Phoenix Mut. Life Ins. Co. v. Greystone III Joint Venture*, 948 F.2d at 142 (Jones, J., dissenting).

In addition, the language of the Code must be read in light of the underlying bankruptcy principles. "[C]ontinued application of the new value

exception comports with the policy underlying Chapter 11 reorganizations. The purpose of Chapter 11 is to successfully rehabilitate the Debtor. *N.L.R.B. v. Bildisco & Bildisco,* 465 U.S. 513, 527 (1984)." *In re Sovereign Group,* No. 89-10721F, 1992 U.S. Dist. LEXIS at *15 n.9.

In conclusion, the court finds that the new value exception to the absolute priority did survive the enactment of the 1978 Bankruptcy Code. This interpretation of the bankruptcy Code is consistent with the guidelines enunciated in *Dewsnup*, as well as the underlying policy of Chapter 11.

Lastly, in clarifying the issues on appeal, the court finds that the single issue before the court is whether the judicially created new value exception to the absolute priority rule survived the enactment of the 1978 Bankruptcy Code.

Although the appellee has briefed the issue of confirmation, the court will not address this issue on appeal. Confirmation of the plan proposed by the Debtor must be addressed by the bankruptcy court on remand.

III. ORDER

Based upon the foregoing, and the court being fully advised in the premises,

IT IS HEREBY ORDERED that the Order of the bankruptcy court filed December 6, 1992, should be, and is hereby, REVERSED, and the case is REMANDED to the bankruptcy court for proceedings consistent with this opinion.

DATED this 15th day of July, 1992.

/S/ ____________________________
HAROLD L. RYAN

UNITED STATES DISTRICT COURT
IN THE UNITED STATES BANKRUPTCY COURT

FOR THE DISTRICT OF IDAHO

In re:	)
	)
BONNER MALL PARTNERSHIP,	) Case No. 91-00801-11
	)
Debtor.	) MEMORANDUM OF DECISION
	)

Ford Elsaesser and Barbara Buchanan, ELSAESSER, JARZABEK, BUCHANAN & DRESSEL, Sandpoint, Idaho, and Jerome Shulkin, SHULKIN, HUTTON & BUCKNELL, Seattle, Washington, for debtor.

Dale G. Higer and Thomas R. Linville, EBERLE, BERLIN, KADING, TURNBOW & McKLVEEN, Boise, Idaho, for U.S. Bancorp Mortgage Company.

U.S. Bancorp has moved for relief from the Section 362 automatic stay and to dismiss the debtor's Chapter 11 petition.

After a hearing, it appears the granting of either motion depends on the ability of the debtor to formulate and obtain confirmation of a plan of

reorganization under the statutory provisions of Chapter 11 of Title 11 of the United States Code. If it is apparent the debtor cannot obtain confirmation of a Chapter 11 plan in accordance with its purposes of reorganization, stay relief is appropriate under the *Timbers* decision of the United States Supreme Court[1] and dismissal would be appropriate under the provisions of 11 U.S.C. § 1112(1) or (2).

Considering the motion for stay relief, as it is possible for the Bank to be adequately protected pending the filing of a Chapter 11 plan through adequate protection payments and the Bank is presently collecting the rents, since the property involved is the property sought to be reorganized, and since no

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[1] *United States Assn. v. Timbers of Inwood Forest*, 484 U.S. 365, 108 S. Ct. 626, 98 L. Ed. 2d 740 (1988).

other ground for cause for stay relief has been shown by the Bank to exist under the provisions of Section 362(d)(1), the issues are dependent on the prospective ability of the debtor to formulate a plan.

The dilemma the debtor faces is the requirement, recognized by the *Timbers* decision, a Chapter 11 debtor must have a realistic prospect of an effective reorganization.

> Section 362(d)(2) also belies petitioner's contention that undersecured creditors will face inordinate and extortionate delay if they are denied compensation for interest lost during the stay as part of "adequate protection" under § 362(d)(1). Once the movant under § 362(d)(2) establishes that he is an undersecured creditor, it is the burden of the *debtor* to establish that the collateral at issue is "necessary to an effective reorganization". *See* § 362(g). What this requires is not merely a showing that if there is conceivably to be an effective reorganization, this property will be needed for it;

> but that the property is essential for an effective reorganization *that is in prospect*. This means, as many lower courts, including the *en banc* court in this case, have properly said, that there must be "a reasonable possibility of a successful reorganization within a reasonable time." 808 F.2d, at 370-371, and nn. 12-13, and cases cited therein. The cases are numerous in which § 362(d)(2) relief has been provided within less than a year from the filing of the bankruptcy petition. And while the bankruptcy courts demand less detailed showings during the four months in which the debtor is given the exclusive right to put together a plan, *see* 11 U.S.C. §§ 1121(b), (c)(2), even within that period lack of any realistic prospect of effective reorganization will require § 362(d)(2) relief. (Footnotes omitted.)[2]

Under provisions of 11 U.S.C. § 1129(b), since the Bank is an undersecured creditor, the Bank would most likely be in a position to block acceptance of any proposed plan of

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[2] *United Savings Assn. v. Timbers of Inwood Forest*, 484 U.S. at 375, 376.

reorganization which contains an impairment of its secured claim.[3] The Bank is definitely undersecured. The property sought to be reorganized, the Bonner Mall, is valued by the Bank at $3.8 million and by the debtor at $2.4 million. The Bank's claim is $6.3 million. The debtor's scheme of reorganization depends upon the reduction of the Bank's claim to the value of the security. It is thus difficult to envision how the debtor will be able to obtain confirmation of a plan under the Chapter 11 statutory requirements, nevertheless, the debtor's contentions will be considered.

Counsel for the debtor contends other unsecured creditors exist who would affect the plan acceptance provisions of

[3] *In re South Village Inc.*, 25 B.R. 987 (Bankr. D. Utah 1982) and *Matter of DRW Property Co. 82*, 57 B.R. 987 (Bankr.N.D. Tex. 1986).

11 U.S.C. § 1126(c), including the claims of the individual partners who comprise the debtor limited partnership. However, the debtor's schedules indicate the only other unsecured claims are $62,178.00 owing to the Magnuson Children Trusts and a priority tax claim of Bonner County of $195,500.00.

Counsel for the debtor further contends it may be possible to obtain confirmation of a plan by providing for separate classes of unsecured debt. Yet, under the provisions of 11 U.S.C. § 1129(a)(8), each class of impaired claims or interests must accept the plan. Otherwise, the provisions of Section 1129(b) apply and the debtor would be required to pay the unsecured claim of the Bank in full under the absolute priority rule provisions of Section 1129(b).

Lastly, counsel for the debtor argues there exists a possibility of a successful reorganization since Harry Magnuson intends to contribute additional capital. An exception to the absolute priority rule exists in the form of "infusion of new capital," commonly called the *Los Angeles Lumber* exception.[4] Simply stated, the debtor can retain an interest in the Chapter 11 estate ahead of creditors to the extent new capital is put into the estate by the debtor. However, the *Los Angeles Lumber* case, and cases decided since, have developed requirements for the exception. One of the requirements, and the most demanding, is the requirement the debtor contribute

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[4] *Case v. Los Angeles Lumber Products Co., Ltd.*, 308 U.S. 106, 60 S. Ct. 1, 84 L. Ed. 110 (1939); *In re Potter Material Service, Inc.*, 781 F.2d 99 (7th Cir. 1986); Polen and Wuhrman, the new value exception to the absolute priority rule, 93 Comm. L.J. 303; *In re Henke*, 90 B.R. 451 (Bankr. Mt. 1988); *Matter of Yasparro*, 100 B.R. 91 (Bankr. M.D. Fla. 1989).

capital "reasonably equivalent" to the interest retained.[5] The value is the fair market value of the property retained, valued at the time of confirmation.[6]

While it is doubtful neither the debtor, nor the members of the debtor partnership, intend to contribute capital to the extent required under the infusion of new capital doctrine, discussion of the subject requires a determination of the value of the Mall.

In arriving at a proper value for the Bonner Mall, problems are posed by both appraisals. The debtor's appraisal of $2.4 million was based only on an income approach. The income approach does not take into consideration the

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[5] *Case v. Los Angeles Lumber Products Co.*, 308 U.S. at 122, 60 S. Ct. at 10, 84 L. Ed. at 123. *In re Potter Material Service, Inc.*, 781 F.2d at 103. *Matter of Yasparro*, 100 B.R. at 97, 98.

[6] *Matter of Yasparro*, 100 B.R. at 99.

occupancy potential of the Mall but considers only the poor occupancy status which presently exists. Yet the Bank's appraisal moves too far in the opposite direction, taking into consideration market value comparisons with successful malls in different localities which make comparable adjustments extremely difficult. The Bank's appraisal is further suspect in the computation of the income approach considering the basic data used and the capitalization rate used.

While the debtor is appealing the $3.2 million assessed valuation figure of the Bonner County Tax Assessor, this figure appears to be more realistic than either the debtor's or the Bank's respective valuation. Accordingly, the value of the Bonner Mall is thus found to be $3.2 million, based on the evidence presented at this hearing.

The debtor will be allowed thirty (30) days to file a Chapter 11 reorganization plan and disclosure statement which is not subject to rejection as a matter of law. If no plan is filed within the thirty day period, both the Bank's motions will be granted without further hearing, under the provisions of Sections 1112(b)(1) and (2) and 362(d)(2) respectively, upon presentation of an appropriate order or orders by counsel for the Bank. If a plan is filed, its potential for confirmation may be considered by notice and hearing, with reduced time requirements if necessary, on motion of the Bank, otherwise the Bank's motions will be denied.

It is further found the debtor has not been guilty of unreasonable delay under the provisions of Section 1112(b)(3) and no bad faith exists on the

part of the debtor or the individual partners of the debtor.

The debtor's motion for use of cash collateral to require the Bank to apply $5,000.00 per month of the Yokes rentals on the $905,000.00 loan will be denied. The funds are sought to be used not by the debtor-in-possession, but are intended to be used in payment of a debt other than a debt of the debtor. While unquestionably the debtor benefitted from the series of transactions which brought the "Yoke's" store into the Mall, the funds are presently being used more appropriately as part of the Bank's adequate protection.

The contents of this decision shall constitute formal findings of fact, conclusions of law and applicable orders.

IT IS SO ORDERED.

Dated this 23rd day of August 1991.

/S/

ALFRED C. HAGAN
U.S. BANKRUPTCY JUDGE